

OVERSIGHT OF THE SEC'S DIVISION  
OF CORPORATION FINANCE

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HEARING  
BEFORE THE  
SUBCOMMITTEE ON CAPITAL MARKETS AND  
GOVERNMENT SPONSORED ENTERPRISES  
OF THE  
COMMITTEE ON FINANCIAL SERVICES  
U.S. HOUSE OF REPRESENTATIVES  
ONE HUNDRED THIRTEENTH CONGRESS  
SECOND SESSION

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JULY 24, 2014

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Printed for the use of the Committee on Financial Services

**Serial No. 113-95**



U.S. GOVERNMENT PUBLISHING OFFICE

91-159 PDF

WASHINGTON : 2015

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## OVERSIGHT OF THE SEC'S DIVISION OF CORPORATION FINANCE

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Thursday, July 24, 2014

U.S. HOUSE OF REPRESENTATIVES,  
SUBCOMMITTEE ON CAPITAL MARKETS AND  
GOVERNMENT SPONSORED ENTERPRISES,  
COMMITTEE ON FINANCIAL SERVICES,  
*Washington, D.C.*

The subcommittee met, pursuant to notice, at 10:07 a.m., in room 2128, Rayburn House Office Building, Hon. Scott Garrett [chairman of the subcommittee] presiding.

Members present: Representatives Garrett, Hurt, Royce, Neugebauer, Huizenga, Stivers, Fincher, Mulvaney, Hultgren, Ross, Wagner, Messer; Maloney, Sherman, Lynch, Perlmutter, Scott, Himes, Peters, Foster, Carney, and Kildee.

Ex officio present: Representative Hensarling.

Chairman GARRETT. Good morning, and welcome. This hearing of the Capital Markets and Government Sponsored Enterprises Subcommittee entitled, "Oversight of the SEC's Division of Corporation Finance" is hereby called to order. Welcome, Mr. Higgins. We will begin with opening statements up here, and then go to you for your testimony.

I yield myself 7 minutes.

Today's hearing will focus on oversight of the SEC's Division of Corporation Finance. Corporation Finance Director Higgins, thank you for agreeing to join us today and for all your hard work that you are doing over at the SEC.

I want to start off today's hearing by commending Chair White, the other SEC Commissioners, and Dr. Higgins for your recent decision to move a potential corporate political disclosure rulemaking, the SEC's Red Flags Agenda.

Far too often during the span of this Administration, it appears that supposedly independent regulators use their position to carry out heavy-handed partisan political attacks. Whether it is the targeting of specific political groups by the IRS, the armed raiding of Gibson Guitar by the Justice Department, the abusing of the law by the National Mediation Board, the bullying of fellow Commissioners by the former head of the Nuclear Regulatory Agency, the obstructing of an investigation of the chemical safety board, the lying about delays by the VA Department, or the illegal implementation of ObamaCare by Health and Human Services, and the list goes on.

The Obama Administration officials and their appointed regulatory cheerleaders need to stop putting political politics above the

rule of law. It is not appropriate to abuse government-granted power to threaten, cajole, intimidate or pressure any opposition into submission.

So I want to thank Chair White for not letting the SEC fall victim to this and for standing up for the SEC's political independence from the White House. I am pleased that the SEC is not joining in this conga line of partisan regulatory abuses and is not turning the disclosure process into a political pinata. After all, the SEC is a disclosure-based agency, and ensuring the appropriate disclosures of material information to investors is at the heart of what the SEC does. And the staff of the Division of Corporation Finance is at the forefront of this important work.

I also want to thank Chair White and Director Higgins and the staff of Corporation Finance for their ongoing work to refocus SEC's disclosure regime on its original purpose. Specifically, I commend them on attempting to address the problems of disclosure overload and for looking at ways to streamline and modernize the integrated SEC disclosure regulatory regime.

If the disclosure process is to be useful to investors, the information required to be contained in the disclosures must be material to the investors and formatted in a way that can be easily utilized by the reader. Over time, more and more requirements have been added to disclosures, rendering them almost useless to the average retail investor.

So we must prioritize reforming this regime to ensure the investors have the appropriate information to make informed investment decisions. By getting what I would say back to the basics of disclosure, I believe we will unlock additional investment capital in our public markets.

Another area where I would like to commend Chair White and Director Higgins again is your recent work on proxy advisors. The guidance the Commission put out several weeks ago is a very good first step in addressing the growing and outside influence being wielded by the proxy advisory industry.

So by clarifying that investment advisors are not required to vote every share of stock they hold for their clients and not every recommendation of the proxy advisers must be followed, the SEC reduced the importance of the proxy advisors and the proxy process.

While these steps taken are very positive, there is still more that should be done. Similar to the worries regarding the extraneous corporate disclosure requirements, there is also a concern about the irrelevant and unnecessary shareholder proxy proposals being brought by activist corporate gadflies.

In a recent speech, Commissioner Dan Gallagher stated, "Taking money out of the pocket of someone investing for retirement or for their child's education and using it instead to subsidize activist agendas is simply inexcusable. It is incumbent upon the Commission to create a regulatory environment that promotes shareholder value over special interest agendas."

I could not agree more with Commissioner Gallagher.

The SEC must take action to limit the abuses being committed by superfluous activist proposals that run counter to and promoting actual shareholder value for the actual investor, the average investor. Specifically, the SEC should amend a number of the rules of



government which investors can afford, offer, what shareholder proposals including four things: increasing the current percentage ownership threshold; lengthening the holding requirement time; providing more specifics around what constitutes ordinary business operations and significant policy issues; and strengthening the re-submission thresholds.

Like the disclosure process, we must also refocus the shareholder proposal so that proposals to address and promote shareholder value receive the attention and consideration they are due. I have highlighted a number of initiatives of the Commission with which I am pleased. Let me turn to several with which I have a number of concerns.

The first is the implementation of the JOBS Act. It is unfortunate indeed that the SEC still does not embrace its mission to promote capital formation with as much zeal and enthusiasm as it does with the Dodd-Frank Act. Our markets and economy are worse for it. This committee recently passed legislation that I sponsored entitled, "The Private Placement Improvement Act."

The purpose of this legislation is to ensure that issuers and investors in certain private offerings under Regulation D (Reg D) do not face overly complex and burdensome regulatory obstacles. So last year, the SEC adopted a rule lifting a ban on general solicitation and advertising private offering under Rule 506 of Reg D as mandated by Title II of the JOBS Act.

Unfortunately, the SEC did not stop there. Instead of simply removing the ban as intended and opening up this market to new potential investors, the SEC decided, for some reason, to issue a separate rule proposal, not called for at all by Congress. That proposal would impose a number of new burdensome regulatory requirements on issuers seeking to use Rule 506. As one commenter put it, the JOBS Act on its base is not authorizing the Commission to attach new and additional conditions to the use of the exemption. It is not for the Commission to rely on its general rulemaking authorities bringing Congress and the President back in line by adding conditions that it believes may enhance investor protection.

However, that is exactly what the Commission did in that case. I believe that many of the additional requirements of the SEC's Reg D proposal will, if ultimately adopted, make Rule 506 a less attractive avenue for small business capital formation. This then is clearly at odds with the goals, let alone the text of the JOBS Act.

And finally, I would like to raise the ongoing view by the SEC of the accredited investor definition, and let me be clear on this point. At a time when small businesses continue to struggle to raise capital, and investors are having difficulty earning a return on their investment, the SEC should not harm small business job creators or the investing public by reducing the amount of participants in this field eligible for private placement.

I know there is a long-held understanding that not all investments are appropriate for all investors, I find it difficult to believe that the SEC will know where to draw the line better than each individual investor. If the SEC decides to act on this, I do encourage it to err more on the side of allowing for investor choice and additional investment options rather than telling more investors whether they can and they can't invest their own money.

With that, I want to thank you again, Mr. Higgins and I now recognize Mr. Scott.

Mr. SCOTT. Thank you very much, Chairman Garrett.

And I want to thank Mr. Keith Higgins, who is the Director of the Securities Exchange Commission's Division of Corporation Finance for testifying before our subcommittee today.

The Securities and Exchange Commission has a good and necessary mission and that mission is to protect the investors, to maintain fair and orderly and efficient markets, and to facilitate capital formation, and any reorganization of the SEC should be made in mind to increase its effectiveness in achieving its mission and in streamlining the corporation with other permanent Federal agencies.

In support of the Commission's mission to protect investors, maintain fair and orderly and efficient markets, and facilitate capital formation, the Division of Corporation Finance seeks to ensure that investors are provided with material information in order to make informed investment decisions, both when a company initially offers their securities to the public and on an ongoing basis as it continues to give information to the marketplace. The Division also provides interpretive assistance to companies with respect to the SEC rules and forms and makes recommendations to the Commission regarding new rules and revisions to existing rules.

I am interested in finding out what changes have been made since the implementation of Dodd-Frank, whose fourth anniversary we celebrate today. And if the SEC is able to conduct any additional reforms in order to improve the Commission's effectiveness, well, I would certainly welcome such reforms.

Furthermore, I anticipate the opportunity to discuss rulemaking and implementation emanating from Dodd-Frank as well as to jumpstart our business startups or the JOBS Act. We need to make sure that in this legislation and subsequent rulemaking, we still allow the Securities and Exchange Commission to evolve with market changes, and that we are not preventing the Securities and Exchange Commission from conducting its intended purpose.

Also, I am very much interested in working and getting an update on how the SEC is progressing with the Commodity Futures Trading Commission (CFTC) and their joint rulemaking for cross-border harmonization and derivatives and swaps dealing. As you know, this comes under Title VII of the Dodd-Frank Act. It is imperative that the Securities and Exchange Commission get together and do this joint rulemaking.

The delay causes confusion in our international markets and failure to come up with harmonization for our cross border, and dealing with our swaps activity puts our business community working on international stage at a very serious competitive disadvantage and could very well allow for a possible reimportation of risk.

May I conclude, Mr. Chairman with this—the key to this cross border is to make sure that the top eight foreign jurisdictions who engage in swaps activity have equal robust regimes to ours, and in order for us to facilitate that, it is you and the CFTC that will determine that to report back to Congress within 30 days if one of these jurisdictions does not meet our robust regimes.

So there is a lot to do there. I would be very interested to know how quickly the CFTC and the SEC will come together in harmony on rulemaking for cross-border swaps and derivatives activities.

With that, Mr. Chairman, I yield back the balance my time.

Chairman GARRETT. Thank you. And the gentleman yields back.

The vice chairman of the subcommittee, Mr. Hurt, is now recognized for 2 minutes.

Mr. HURT. Thank you, Mr. Chairman.

Mr. Chairman, thank you for holding today's subcommittee hearing to conduct oversight over the SEC's Division of Corporation Finance.

The Division has a number of consequential initiatives on its agenda including the review of our corporate disclosure system and finalizing key pieces of the JOBS Act, and I am looking forward to hearing your testimony today.

I am encouraged by Chair White's comments on the need for the Commission to conduct a review of its corporate disclosure system. She and other Commissioners noted disclosure overload is having negative impacts on investors, public companies, and the SEC itself. Fostering capital formation in our capital markets requires consistently reliable information on public companies. However, too much information for the sake of information can create inefficiencies and confusion.

Streamlining our disclosure regime to better reflect the SEC's mission of protecting the investors, maintaining fair, orderly, and efficient markets, and facilitating capital formation will lead to benefits for both business and investors. I also want to emphasize that it is imperative that the SEC not lose sight of its third important and sometimes neglected mission, again, facilitating capital formation.

Congress has provided the SEC with broad discretion to amend securities laws and regulations without sacrificing key investor protections. However, the JOBS Act, and the numerous bipartisan bills that have passed out of this committee highlight the fact that the SEC needs to do more to promote capital formation through common-sense updates to its regulations.

One such bill that Representative Sewell and I have introduced passed this committee with strong bipartisan support to provide relief to small issuers from the disproportionate cause of XBRL compliance. The SEC should recommit itself to promoting capital formation that will spur growth and opportunity, beginning with a full implementation of the JOBS Act as well as other recommendations from the SEC's forum on small business capital formation.

I would like to thank Mr. Higgins for appearing before our subcommittee today. I look forward to your testimony.

Thank you, Mr. Chairman. I yield back the balance my time.

Chairman GARRETT. I thank the gentleman, and the gentleman yields back.

The gentleman from California is recognized for 4 minutes.

Mr. SHERMAN. Four minutes, thank you.

There are a number of issues I would like to discuss. One of those is the Financial Accounting Standards Board (FASB) lease accounting project that I realize comes not directly under your purview but you are, to some extent, responsible for the need for total

disclosure—for a full disclosure, and leases are being properly disclosed now. Since it is not broke, the folks in Norwalk, Connecticut, feel they need to fix it. The effect will be to add \$2 trillion to the balance—to the liabilities of the balance sheet of American business because many tens of thousands, I would say many hundreds of thousands will be in violation of their loan covenants and perhaps cut our GDP by about half a point.

Others on this committee have heard me talk about this, and I hope that you would realize as your chairman has stated here that while you can say you designated—you have delegated everything to the Financial Accounting Standards Board, that this is an SEC responsibility.

Second, you are about 2 years behind on issuing regulations under the Franken-Sherman amendment to deal with credit rating agencies. They gave AAA to Alt-A, and the economy tanked. All of the same pressures are there now. That is to say, the issuer of the bond selects the credit rating agency.

If I had been able to select the people who graded my tests in college and been able to pay them an average of \$1 million per test they graded, I would have done better in college.

Day trading and now minute trading, second trading, millisecond trading, is an issue that comes up. It makes people think that they can't invest in a fair market if they don't have a computer that is specially wired to the market to beat somebody else's computer, let alone any human making the decision. It used to be that if there was a tiny spread, sometimes that went to the buyer, and sometimes that went to the seller. Now, all of it is scooped up by those engaged in this computerized trading.

And it is also very hard to see what benefit it has provided by having some of our smartest young people sit at home all day, avoid shaving, and spend the whole day buying and selling stocks and being out of the market at the end of the day. I think there is a role for people to make money in our capitalist system but it usually should be tied to something socially productive.

And finally, Mr. Higgins, I hope you will discuss either in your opening statement or in questions the fact that the British and others have transactions taxes. How can we establish a per transactions tax that is low enough, that it doesn't push business offshore—I think London is doing pretty well—and it would have the effect of raising some revenue because I am sure you are here to tell us that the SEC doesn't have sufficient revenue to do its job such as writing the regulations under the Franken-Sherman amendment that you are 2 years late on. just in case I didn't mention that.

And it would also have the effect of discouraging meaningless trades where people are in and out of a stock in a minute or a second. So I hope you will address those issues in your opening statement.

I yield back.

Chairman GARRETT. The gentleman yields back.

Mr. Royce is recognized for 2 minutes.

Mr. ROYCE. Thank you very much, Mr. Chairman.

First, let me welcome Mr. Higgins, and say thank you. To date, your office has been very professional and forthright in their interactions with me and with my staff.

And I would also praise the Commission because over the last 5 years, it has been very active in the pursuit of insider trading. I think you have charged now over 570 defendants in civil insider trading cases for that period of time. It is easy for our constituents to understand insider trading when it involves a group of friends sharing information maybe over the golf course or through an email exchange between them. It becomes a little murkier for investors, and I assume for the SEC, when the exchange of information is shrouded in contracts and it doesn't look like something that you have seen before.

I am very interested in the Commission's process for looking at novel and creative deals to ensure that they are robustly reviewed to ensure strong investor protection and market transparency in places where people would try to use insider trading as part of a scheme, and I look forward to your answers to some questions on these issues this morning.

And again, I thank the chairman for holding this hearing, and I yield back.

Chairman GARRETT. The gentleman yields back? Okay.

The gentlelady from New York is now recognized for 3 minutes, or as much time as she is going to consume.

Mrs. MALONEY. First of all, I thank you, Mr. Chairman, for holding this important hearing, and I welcome Mr. Higgins.

There has been a great deal of discussion lately on maintaining confidence in our markets, and I have always said markets run more on confidence than on capital, and it is important that we maintain it. But one of the most important and most underappreciated sources of confidence is the accuracy and transparency of the financial statements that public companies are required to file, and this is where the SEC's Division of Corporation Finance plays such an important role.

As an investor, if you are going to commit your capital to a company, you need to know at a minimum how much money the company already has, how much it is expected to make every quarter, what its normal day-to-day operating costs are, and how much it already owes to other creditors. This is the information that public companies are required to disclose every quarter in their financial statements.

If an investor cannot have a basic level of confidence in these financial statements, that the numbers are accurate and any major caveats are disclosed, then the investor won't commit his capital to this company, period. The fact that investors around the world are so willing to invest in our companies and our markets is a testimony to the professionalism and dedication of the SEC staff who review those financial statements, and it is difficult work, sometimes tedious, often frustrating, and always complex.

The confidence that investors place in these financial statements has been hard won over several decades, but it is truly the grease that keeps the wheels of commerce spinning.

So I look forward to hearing from our witnesses today, and I yield back the balance of my time.

Chairman GARRETT. The gentlelady also yields back.

At this point, we return to our panel, our witness, for his opening statement. Mr. Higgins, you are recognized for 5 minutes. Obviously, your written statement will be made a part of the record, and, as with every witness, we remind you to pull the microphone as close as you can, if that is not inconvenient to you. And again, we welcome you here and you are recognized for 5 minutes. Mr. Higgins?

**STATEMENT OF KEITH F. HIGGINS, DIRECTOR, DIVISION OF CORPORATION FINANCE, U.S. SECURITIES AND EXCHANGE COMMISSION**

Mr. HIGGINS. Thank you, Chairman Garrett, Ranking Member Maloney, and members of the subcommittee. My name is Keith Higgins, and I am the Director of the Division of Corporation Finance at the Securities and Exchange Commission.

I appreciate the opportunity to testify today on behalf of the Commission about the Division's activities and responsibilities. As has been said already, the mission of the Commission is to protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation. The Division promotes this mission by overseeing the agency's review of company disclosures to the investing public, seeking to ensure that investors have access to materially complete and accurate information upon which to make voting and investment decisions.

The Division generally carries out its mission by selectively reviewing company filings by providing interpretative guidance about the securities laws and by making rulemaking recommendations to the Commission in the areas of company disclosure and securities offerings.

Through our filing review program, the Division reviews the disclosures and financial statements of reporting companies to monitor and enhance compliance with our disclosure and accounting requirements. The Sarbanes-Oxley Act of 2002 requires the Commission to review companies' disclosures at least once every 3 years, and more frequently where circumstances warrant.

In addition to these mandated reviews, the Division selectively reviews registration statements and other filings relating to public offerings, business combination transactions, and proxy solicitations. During fiscal 2013, the Division reviewed the filings of more than 4,500 reporting companies, and I expect our reporting company review of statistics will be similar for fiscal 2014.

The Division also provides guidance to market participants and the public through, among other things, no-action and staff interpretative letters and staff and accounting legal and accounting bulletins. Most recently, as the chairman mentioned, the Division, together with the Commission's Division of Investment Management, issued a staff legal bulletin on proxy advisory firms that provided guidance on the availability of exemptions under our Federal proxy rules upon which these firms typically rely.

It also provided guidance to the investment advisors about their responsibilities in voting client proxies and in retaining and overseeing proxy advisory firms. As to our rulemaking effort, the Division has been focused on implementing the mandatory rulemaking

provisions of the Dodd-Frank and JOBS Acts. Under Dodd-Frank, the Division has been involved in numerous completed rulemakings including say-on-pay and say-on-frequency votes for executive compensation, disclosures about representations and warranties and asset level review of asset-backed securities offerings, compensation committee listing standards and disclosure, disqualification of bad actors under Rule 506, specialized disclosures relating to mine safety and conflict minerals, as well as removing a person's primary residence from the network calculation in the accredited investor definition.

The Division is currently developing recommendations for final rules on the following: disclosure of asset level data and offering of asset-backed securities; risk retention for securitizers of asset-backed securities; and CEO pay ratio. We are also working to implement the remaining Dodd-Frank executive compensation rules and payments by resource extraction issuers as well as working on the mandated review of the accredited investor definition.

The Division has also been leading a number of the rulemakings under the JOBS Act. As the chairman mentioned, last year we adopted final rules on general solicitation in the Rule 506 offerings, and at the same time issued a rule proposal to amend Regulation D to enhance the Commission's ability to assess the development of the private offering market.

In October of 2013, the Commission published a proposal to implement the crowdfunding rules under the JOBS Act. And in December of 2013, the Commission proposed rules to enable companies to offer up to \$50 million in any 12-month period under a new and expanded Regulation A.

The Division is preparing recommendations for final rules on the Regulation D, crowdfunding, and Regulation A proposals, and we are also working on proposals to implement the Title V and VI changes to the 12(g) standards under the Exchange Act.

Finally, the Division, as the chairman has mentioned, is leading the Commission staff's effort to comprehensively review our disclosure system to review the rules, specify what companies must disclose in their filings and to make recommendations on how to update them to facilitate timely, material, and more effective disclosure. Initially, the Division is focusing its efforts on the business and financial disclosures that are included in periodic and current reports. After which, we will focus on the governance and compensation information provided in proxy statements.

The staff is seeking input from a broad range of companies, investors, and other market participants on how to modernize and update the disclosure so we can make it both more meaningful for investors and less burdensome for companies.

Thank you again for inviting me to testify today. I am happy to answer any questions you may have.

[The prepared statement of Director Higgins can be found on page 40 of the appendix.]

Chairman GARRETT. Thank you, again, for your testimony.

At this point, I recognize myself for 5 minutes, and I just have a few matters to go over.

You went through a whole series of things as far as what has been done and the listing of things that are on the plate still, I

guess. One that I touched upon in my opening statement was with regard to proxy advisor firms. And as you indicated, you recently issued guidance, and as I said in my opening statements that they seem to address the concerns raised by me and also raised by investors and businesses also at the past SEC roundtables and also at the hearings that we held here in this committee last year.

From a reading of it, the guidance appears to require the advisory firms to disclose, for one thing, conflict of interest. Also, it requires them to put a system in place to address those conflicts of interest and also to try to ensure accuracy that correlates advice to the goals of the client fund and clarifies when institutional investors must vote shares and how they must engage in advisory firms. I think I touched upon that in my opening statement as well.

So all those things are important steps, I think, forward in creating oversight over these firms and ensuring a fair, and what we call an even-handed shareholding voting process. But there are a couple of points just to dig in to a little bit. How is the SEC going to—not that they have done this—oversee the implementation of all these with regard to the advisory firms?

Mr. HIGGINS. Mr. Chairman, we keep our eye on—we monitor the market, the guidance is out—

Chairman GARRETT. Yes.

Mr. HIGGINS. The proxy season really is typically the first 4 months of the year so we are sort of in a lull in the proxy season, but we would expect to watch to see what happens. We get feedback from market participants as to how it is working, but we don't yet have a work plan on how we are going to test how well the guidance did. We expect—because market participants haven't been bashful in letting us know where the problems are, so we are hoping that we continue to get feedback from all sides of the question.

Chairman GARRETT. Okay. So just to go down on one point, as far as the complex, there is not going to be a reporting requirement on the conflict for each particular one that they identify then, for example?

Mr. HIGGINS. What the guidance said is that the proxy advisory firm has the obligation, if there is a significant relationship that has to be addressed—

Chairman GARRETT. Right.

Mr. HIGGINS. —the guidance said that the proxy advisory firm must provide that to the client on or about the time that it delivers the report, and we are confident that the proxy advisory firms can implement that.

Chairman GARRETT. Okay.

Mr. HIGGINS. There is no one-size-fits-all.

Chairman GARRETT. Right. Okay. So we are in a lull because it just passes now, so when we get through the next period, the next season of proxy advisors, will you be reporting back to us? Will you be issuing a report? How do we know as far as the success or not in this area?

Mr. HIGGINS. Right. We don't have any current plans to issue a report, but it is something we will give some thought to. As far as how you measure success, it will be hard. There will be some things that won't be particularly transparent to us. You mentioned



the guidance provides some guidance on how clients can agree with their investment advisors when and how to vote shares.

Those are the agreements that we might not be privy to; if they are registered investment advisors, our Office of Compliance Inspections and Examinations could take a look at that and add that to the list of things that they look out for when they come in to do their exams.

Chairman GARRETT. All right. Let me—my time is going by.

Moving on to shareholder proposals and what have you, do you agree with me that the SEC should amend a number of the rules that govern which investors can offer what and what shareholder proposals—I won't go down it—but just in general in that area?

Mr. HIGGINS. There has certainly been a lot of angst on the shareholder proposal process. The one thing about it is that nobody is completely happy with the process.

Chairman GARRETT. Right.

Mr. HIGGINS. We understand that. I think that we have a shareholder—yes, rulemaking position in on resubmission thresholds, Commissioner Gallagher has given speeches on—

Chairman GARRETT. Yes, I have heard that.

Mr. HIGGINS. —thresholds. All of those are issues on which there is widespread debate. I don't think the staff has a view on what should be done. I think the only observation I would make is that any proposal will need to try to find a consensus.

Chairman GARRETT. So let me just—my time is almost out here. Will you commit to proactively monitor the proxy voting process to ensure that it is not abused? Because there are allegations, I am sure you know, from the stakeholders that certain activist shareholders are trying to do things through these methods that they maybe cannot accomplish in another means. So will it be your goal to try to proactively monitor what they are doing? The proxy voting process to ensure that it is not abused by just this small class of what we call activist shareholders and special interest groups who are looking to advance their own particular goals that may not be to the detriment overall of the other investors and other shareholders?

Mr. HIGGINS. This is on the 14A shareholder proposal process. We devote a substantial amount of staff resources every year during the 3 months of the proxy season on reviewing shareholder proposals on calling balls and strikes, if you will, on what proposals can be included and excluded.

Chairman GARRETT. Okay.

Mr. HIGGINS. So we are actively involved in watching that.

Chairman GARRETT. All right. I appreciate it.

The gentlelady from New York is now recognized for—

Mrs. MALONEY. Thank you.

Mr. Higgins, earlier this year the New York State Common Retirement Fund, which is overseen by our State Comptroller Tom Dinapoli, tried to get a shareholder vote at the annual meeting of two large financial institutions on a resolution concerning the disclosure of incentive-based compensation for employees who take high risks for these institutions. Unfortunately, both of the financial institutions decided to exclude the comptroller's resolution from their proxy materials and the staff in the Division of Corporation

Finance sided with these institutions in this dispute saying that the financial institutions could exclude the resolution because it dealt with so-called "ordinary business operations."

This seems to be contrary to the SEC's previous statement that incentive-based compensation for bank employees who take material risks is in fact a significant policy issue and does not merely concern so-called "ordinary business operations." Because the staff's decision appeared to be based on a simple misreading of the resolution, the comptroller tried to appeal the decision to the full Commission, but the staff refused to even present the appeal to the Commissioners. And this was very troubling to me. I know that throughout the hearings on Dodd-Frank, the incentives were talked about, that the incentives were there to increase risk as opposed to sound financial practices.

This was troubling to me. Can you please explain to me how this happened?

Mr. HIGGINS. Right. Well, the proposal of which you speak, the reason that the staff concluded that it could be excluded was that the proposal was drafted to focus on employees who could expose the institution to material risk, that was the first cut that needed to be made. The second was then to look at any incentive compensation those persons might be paid. The significant policy issue, and these are technical issues that maybe only a lawyer can love, had to do with incentive compensation paid to individuals who expose the institution to material risk. The proposal as drafted talked about employees who could expose the institution to risk whether or not they receive any incentive compensation. On that basis, and again a very technical area, the staff did not believe the proposal met the significant policy issue standard, and as a result agreed with the company that it could be excluded.

Mrs. MALONEY. Okay. Will you commit to working with the New York State Common Retirement Fund next year ahead of time so that we can prevent this situation from happening again?

Mr. HIGGINS. The one thing about the shareholder proposal process is that we stand in the middle. We provide informal advice to people who ask us about what we believe can be excluded and what can be included. We try to be scrupulously fair and stand in the middle and not appear to aid either side. I believe it would be problematic for us to either get together with companies or with proponents in advance because it would seem as if we would have already decided the issue before it is presented. We have to let each side advocate for their respective positions.

Mrs. MALONEY. Yes, but giving them the guidelines of how their proposal could be—

Mr. HIGGINS. We hope our letter was clear on how they might revise it.

Mrs. MALONEY. Thank you.

I am a big advocate of your XBRL system which companies file their financial statements in the standardized structure data format, and I believe it is the way of the future, and I must say that many of the companies that I am privileged to represent are really thrilled that they can have a standard format and get the materials done each month and get the information back. And I think

that you should be moving toward a structured computer-readable financial statements.

Where does this stand right now? My time is almost up. Are you doing an RFP? Are you developing this in-house? What data elements are you capturing in the XBRL system? And basically, what they are trying to—what they are required by law to report to you, you are putting in a standardized form so it is easier for companies and easier for you to understand and for the public to understand?

Mr. HIGGINS. Correct.

Mrs. MALONEY. Where does it stand right now?

Mr. HIGGINS. That is what is required right now, the financial statements are required to be in XBRL. There is a separate schedule that needs to be filed in XBRL that has the financial statements and the financial statement footnotes tagged so that there is—

Mrs. MALONEY. Is it computerized and available now to companies and is it available online to members of the public—

Mr. HIGGINS. It is.

Mrs. MALONEY. —who want to study it?

Mr. HIGGINS. The XBRL data is available to anybody who wants to go online. Companies have to file it and all companies have—

Mrs. MALONEY. Did you develop it in-house?

Mr. HIGGINS. It was before my time. It was several years ago. XBRL is a relatively well-known computer technology that—

Mrs. MALONEY. But the standardized form, from what I am being told by some companies, seems to be new. They feel that this cuts their paperwork and makes it easier for them to file, the changes that you have made. Anyway, thank you.

Chairman GARRETT. That was an improvement. Great. Thank you. The gentlelady yields back.

The vice chairman of the subcommittee is recognized for 5 minutes.

Mr. HURT. Thank you, Mr. Chairman.

Again, Mr. Higgins, thank you for appearing before our committee and for your testimony.

As we discussed prior to your testimony, I represent Virginia's Fifth District. It is a rural district. We have the University of Virginia, which I know you are familiar with, in our district.

Access to capital is an extremely important subject for me as a Representative of a district where in some places we have unemployment as high as nearly 10%. Job creation is the order of the day. That seems to me to be the most important thing facing my constituents, and capital formation, obviously, is an important part of that.

Because of the University of Virginia, we have emerging growth companies that are coming out of the research that takes place there at the University of Virginia. And I am glad that Mrs. Maloney mentioned XBRL, because that is something—constituents that I have talked to who have had to deal with that system find it less than satisfactory and have real concerns about the cost and ultimately whether or not it benefits the investor in any way, shape or form.

So from the people that I talked to and from my constituents, we believe that it is not ready for primetime, although hoping that at

some point that it will be useful to investors but at this point that it is not and so we have introduced—so Representative Sewell and I have introduced legislation that would exempt emerging growth companies from those requirements, certainly until that time that it is a more useful program.

But with that said, I know that the JOBS Act required the SEC to study the Reg S-K. You all came back with a report and it sounds like Chair White has asked for follow-up. I think there was probable—there were some who were disappointed that there was not more meat in the original report. It was presented, it was based on that.

My question in terms of the disclosure issue and XBRL was very much a part of that regime—I guess my question is as you all go forward, looking at corporate disclosure, what are your goals and what are the timelines? This is very important because I think there is a lot of concern about the pace at which these JOBS Act proposals have been implemented. What is the goal in your mind of this corporate disclosure project and when can we see some results?

Mr. HIGGINS. It is hard to predict when we will see results. What the Division is doing right now is, as the Chair asked, preparing recommendations. We would expect that those recommendations would likely take the form of some sort of a release that could be exposed to the public because although within the Division we know disclosure pretty well, we need to hear from companies, investors, market participants as to what it is they want, what it is that is burdensome, what it is that could be added to. There is a whole host of things on which we need public input.

So we are moving on that. The next step would be to get—

Mr. HURT. How would you articulate the goals of—what were the goals? And again, if you could—

Mr. HIGGINS. Our goal—

Mr. HURT. Go ahead.

Mr. HIGGINS. —always is to provide investors with material information with which they can make voting and investment decisions, and to make it as less burdensome on companies as possible to provide that information. We know there are examples of information that is now required, the historical stock price chart. People don't go to the 10-K to get a company's stock price, they go on Yahoo Finance or Google or something.

So these are things that could be cut out. There will be small steps. There may be bigger steps that can be taken.

But our goal is effective disclosure. The phrase “disclosure overload,” to the extent that there is more disclosure than investors need, we don't think that is right. In the process, we may find out that investors are looking for more and we have already heard from some investors that they think disclosure can be enhanced on issues like short-term borrowings. So our goal is to find the balance.

Mr. HURT. And I would ask you to also consider that obviously these disclosure requirements, in addition to—in many instances not providing useful information, efficient information to investors, they cost companies a lot of money for an emerging growth company. Those dollars could be put into research and development as

opposed to something that is useless to investors and it is not helping them at all. So I would ask you to, obviously, consider that as part of your goal.

Thank you, sir.

Mr. HIGGINS. Thank you.

Chairman GARRETT. The gentleman yields back.

Mr. Perlmutter? Welcome to the committee.

Mr. PERLMUTTER. Thanks, Mr. Chairman. Good morning.

Chairman GARRETT. Good morning.

Mr. PERLMUTTER. I would like to first, if I could, ask unanimous consent to make a letter to you and to Congresswoman Maloney dated July 23rd from the Council of Institutional Investors a part of the record.

Chairman GARRETT. Without objection, it is so ordered.

Mr. PERLMUTTER. And then I would like to yield the balance of my time to Mr. Scott.

Chairman GARRETT. Mr. Scott is recognized.

Mr. SCOTT. Thank you very much, Mr. Chairman.

Let me ask you—I have a couple of points I want to ask you. But first, now under Section 953(b), corporate governance, the SEC is to come back with the rulemaking regarding compensation for top executive pay. And you have an October deadline of coming up with that rule, how are you progressing with that?

Mr. HIGGINS. Well, the 953—

Mr. SCOTT. Yes.

Mr. HIGGINS. The CEO pay ratio?

Mr. SCOTT. Yes, 953(b), the Wall Street Reform Act requires the SEC to issue a regulation mandating that companies disclose a ratio pay between the CEO and their median employees and we trying to get at this—the whole issue now is fairness and equality in pay.

Mr. HIGGINS. The Commission issued a rule proposal last September on which we have received over 128,000 comment letters, 950 of which are unique. It is on the regulatory rulemaking agenda of the Commission for this fiscal year which, as you know, has an October deadline.

Mr. SCOTT. Right.

Mr. HIGGINS. But that was set back at the time, it is—what the Commission thought it could get accomplished in that timeframe. There is no strict deadline on that but it is the goal that the Chair has indicated. She would like to get a final rule done on that this year and we are working to develop recommendations for the Commission to make that happen.

Mr. SCOTT. Yes. But do you feel right now you will be able to meet that deadline or will it be an extension? I know there has been some discussion.

Mr. HIGGINS. Right. We are working hard on a recommendation for the Commission which they could act upon during the course of this year, but I can't promise that the Commission—I can't speak for the Commission. They set their agenda. I can't speak for what their deadline will be on acting on that proposal.

Mr. SCOTT. Have you gotten tangible research as to how wide this gap is? Do you feel that this disparity is a crucial factor in the governance or corporate governance in your role? I guess what I am

asking is does the SEC feel the sense of this wide gap within what top CEOs are making?

And I don't, at all, deny people for making money. They should, certainly. But there is an issue is is this grasp for this money way at the top of the corporate structure detrimental to this disappearing of the middleclass.

Mr. HIGGINS. I am not sure that the Commission has a view on that. I think what the Commission has a view on is that Congress enacted 953(b), directed the Commission to adopt rules. We are working to get those rules done as we are with all of the mandated rulemakings that we have been—

Mr. SCOTT. And so you are—what I mean is the part of the law is there and we can expect the SEC to come forth with that rule-making?

Mr. HIGGINS. It is a mandate of Congress and we take it seriously.

Mr. SCOTT. In my opening remarks, I did touch upon the cross border.

Mr. HIGGINS. Right.

Mr. SCOTT. And I want to rectify my comments on that. My understanding is that the—we just passed the bill which is the SEC reauthorization that does require you and the SEC to issue a joint rule. This is very critical as we move forward because it involves an international situation.

Swaps and derivatives are now a growing part of the world economy, \$800 trillion of the world economy. So in that light, could you just tell me if there have been any discussions going forward within the SEC in reaction to House Resolution 1256 where we incorporated that requirement that you and the CFTC come up with a harmonization for cross border and the reauthorization?

Mr. HIGGINS. The cross-border swap area is not part of what the Division of Corporation Finance does—that is trading and—

Mr. SCOTT. Yes, I understand that but—

Mr. HIGGINS. I would be happy to have someone get back—

Mr. SCOTT. Yes.

Mr. HIGGINS. —to you on that but it is not anything of which I can speak because I simply don't know.

Mr. SCOTT. Okay. I would—I just want to clear that up because I might have misspoken in thinking that you did qualify that but that is a great concern to many of us on both the Financial Services Committee and the Agriculture Committee, and we haven't heard anything from the SEC—

Chairman GARRETT. So can we follow that up maybe in your next round?

Mr. SCOTT. Thank you.

Chairman GARRETT. Mr. Royce is now recognized for 5 minutes.

Mr. ROYCE. Thank you, Mr. Chairman.

Again, as it relates to insider trading as I mentioned in my opening, take for example a company that seeks to purchase another firm. We call the other firm the target. The company enters into a contractual relationship with a hedge fund to purchase the shares of the target for the benefit of the company before the announcement of the intent to acquire the target.

The company and the hedge fund basically call their agreement a joint venture or they call it a partnership. Does the existence of the contract somehow make what would otherwise be illegal trading by the hedge fund in the target companies' stock legal insider trading?

Mr. HIGGINS. Congressman, I obviously can't speak to any particular situations, but in general, there is—and I would also say that it is really the Division of Enforcement that handles insider trading but I am familiar with the law in that area. There are two rules under the Commission's jurisdiction that address insider trading. The first, Rule 10b-5, requires—in order for someone to be liable for insider trading under 10b-5 based on Supreme Court precedent, there must be a breach of some duty owed by the person trading to the source of the information.

In the instance that you cite, if one company brought another company in and said, let's work together, I want to take this company over, I will let you in on it, that wouldn't be any breach of any duty.

Mr. ROYCE. But let me throw in one other factor for your consideration before we get to the other caveat.

Mr. HIGGINS. Okay.

Mr. ROYCE. What if the company had taken steps towards a hostile deal before entering into the agreement and the company and the hedge fund's interest were not aligned under the terms of the agreement?

Mr. HIGGINS. Right. Taking substantial steps, the other insider trading rule is 14e-3—

Mr. ROYCE. Okay.

Mr. HIGGINS. —which deals with tender offers and when a bidder has taken substantial steps to commence a tender offer, anyone who gets material nonpublic information from that bidder who trades on it is liable for insider trading irrespective of any breach of a duty. So that is how 10b-5 and 14e-3 work differently.

I am not sure I completely understood the—where the one person might be working counter to the purposes to—

Mr. ROYCE. Why they wouldn't be aligned? In my view, they wouldn't be aligned because one party can walk away from the transaction at any time. The other party, the hedge fund, clearly is now tied in to the agreement, is benefiting from the rise in the stock price as a result of the rumor being driven of the hostile takeover, right? So these interests are not, in fact, aligned. And I am also confused as to how this is any different than a couple of buddies out on a golf course—something we have seen a lot, and something that you have seen a lot—exchanging information are not sellers of the target shares subject to the same imbalance of information as investors in the stock that is victim to a traditional insider trading scheme? I would assume the fraud is the same regardless of the structure, and does this somehow labeling this buying scheme a joint bid insulate it from insider trading charges? That is my concern.

Mr. HIGGINS. And that is a question that I don't think that either the Commission or the courts has answered on whether two parties getting together counts on co-bidders and—

Mr. ROYCE. And I would also like to know what the SEC's process is for examining a novel or a creative deal structure and what are the SEC's options to investigate conduct related to these types of transactions?

Mr. HIGGINS. If a filing comes in to the Division, it would come in, typically, to us either through a proxy solicitation or a tender offer or a merger, we have criteria that we use to screen. If it meets the criteria and we look at it and typically hostile deals tend to meet our criteria for screening. We would look at it. We would provide comments. We would review it against the applicable disclosure requirements as well as the anti-fraud provisions of our laws, make comments to the participants and work through those, the goal always being that investors get clear, accurate material information.

Mr. ROYCE. Thank you.

Thank you, Mr. Chairman.

Chairman GARRETT. I thank the gentleman.

Mr. Scott is recognized for his second 5—

Mr. HIMES. Thank you, Mr. Chairman. I yield my time. Do you want my time?

Chairman GARRETT. No, actually it is—

Mr. HIMES. Okay.

Chairman GARRETT. We are just going down the row. You have not had your time, I don't believe or—

Mr. HIMES. Do you want my time?

Mr. Chairman, I yield my time to Mr. Peters.

Chairman GARRETT. Okay. So, here we go. Mr. Himes is recognized, and yields his time to Mr. Peters.

Mr. Peters, you are recognized.

Mr. PETERS. Thank you, Mr. Himes, and thank you, Mr. Chairman, for that. I appreciate it.

Hi, Director Higgins. It is great to have you here. I would like to briefly discuss some legislation that I introduced last year and ask you a couple of questions following that, that would amend financial disclosures of publicly traded companies. As you know, publicly traded companies must disclose certain information in registration statements, prospectuses, and other periodic mandatory filings including a general description of the company's business, a description of the company's principal products and services, and a description of the company's subsidiaries.

Companies must also disclose the total number of employees that they have and anticipated changes in the number of employees working in various corporate departments. While corporations must disclose their total number of employees, they do not need to disclose where they are based. Elimination of 700 jobs in the United States, for example, and the creation of 1,000 jobs abroad, in China perhaps, would register only as a net gain of 300 jobs.

I believe responsible investors have a right to know how publicly traded corporations are spending their money and whether they are hiring and investing in the United States or sending earnings overseas, where companies are hiring or laying off employees could be determinative, and it could be material information, certainly, for potential investors.



My bill, the Outsourcing Accountability Act, will simply add location of employees to the annual SEC disclosure requirements. These reports would need to disclose the total number of employees in the United States broken out by State as well as the total number of employees abroad, broken out by country. The SEC would be given the authority to issue regulations to implement this measure. And finally, the bill would harmonize with the JOBS Act by exempting companies for the first 5 years after their IPO to avoid increasing compliance burdens on newly public employees.

So, Mr. Higgins, although I have introduced this legislation to require this disclosure, do you believe that the SEC currently has the authority to implement those proposals through rulemaking and without congressional action?

Mr. HIGGINS. Does the Commission have a—I believe the Commission would have authority to implement—to adopt a rule such as that even absent a congressional mandate.

Mr. PETERS. Okay. Good.

Do you believe that the disclosing of the physical location of employees would impose less of a burden on companies than disclosing the median of the annual total compensation of all employees of the company and the ratio of that median to the annual total compensation of the CEO, which was a rule proposed by the Commission just last year as you know?

Mr. HIGGINS. I don't really have any sense of—we don't have information on what it might cost to do it. Just off the top of my head, it seems less burdensome, but without actually getting information from participants, from the companies that actually have to prepare this information, it would be hard for me to speculate.

Mr. PETERS. Obviously, the calculations involved in the rule that you did last year are fairly involved, and it would certainly be reasonable to think that a company—it would be very easy for them to know where they send their paychecks every month. That is information that is probably just a push of a button away.

Mr. HIGGINS. Right.

Mr. PETERS. Is that an accurate statement, sir?

Mr. HIGGINS. It seems—that seems right to me. Yes.

Mr. PETERS. Right.

And given the changes are straightforward and certainly not particularly complex, I think given the fact that the company certainly should know where they send their paychecks every month or however often they pay, do you believe the SEC has the capacity to implement this proposal without difficulty?

Mr. HIGGINS. If Congress passes a law, and the President signs it mandating that the Commission adopt rules, the Commission will proceed to do that. What we would do in that and as we do with any rulemaking is that we would have our economists looking at the cost and benefits of such a rule. We put it out for a notice-and-comment rulemaking so that we could get public input from companies, from investors, and from other market participants as to their views on the rule, and we would take that all together in fashioning final rules.

But I don't see any structural or other impediments to adopting a rule such as that just as long as we have enough time and ability to attend to it and we have a pretty full rulemaking calendar.

Mr. PETERS. Right. I realize that. Thank you, Director Higgins. I appreciate that.

Mr. Chairman, I yield back.

Chairman GARRETT. The gentlemen yields back. Mrs. Wagner is recognized for 5 minutes.

Mrs. WAGNER. Thank you, Mr. Chairman.

I thank Mr. Higgins for being here also.

In your testimony, sir, you indicated that you all are seeking input from a broad range of companies, investors, and other market participants. What does the Division plan to do to address the 43 remaining recommendations of the SEC's forum on small business capital formation?

Mr. HIGGINS. We do every year have a government business forum on small business capital formation. We get input from the participants so they put together recommendations. We, as you know, received 43 recommendations this year.

It was interesting to us that none of them had a high priority attached to them. All were either medium or low priority. Obviously, the ones that were medium were the ones we should be looking at first.

Of the top 10, I think about 8 or 9 of them dealt principally with the existing rulemaking proposals that the Commission has already—mostly either a crowdfunding or Reg A plus and so with those, we are taking those into account as we work through to get a final rule proposal on those rules.

Mrs. WAGNER. In the past, Congress has had, I think, very little insight into the SEC's process. And here, I am talking really about the process for evaluating the small business forums, recommendations. Do you, in fact, have a process and would you be willing to work with the committee to make your process a little more open or transparent?

Mr. HIGGINS. We do have a process. We work with the forum and we get their recommendations. We put a report together on what the recommendations are and to the extent that we have the opportunity to talk to the Commission to see if they want us to pursue those, we would—something that we would—

Mrs. WAGNER. As I have said, we would love to be brought into the process more. I think it is a little more transparent and I am wondering if you are willing to allow us to do that. It might help in prioritizing some of the legislation and policy we put forward.

Mr. HIGGINS. We are happy to work with the committee on any matter.

Mrs. WAGNER. Great.

Mr. Higgins, angel investors such as St. Louis Archangels in my district are creating jobs across the Nation with your investment in startups. What is the Division doing to make sure that any rules under consideration do not hurt angel groups or harm the prospects for high potential startups across America?

Mr. HIGGINS. We don't single out angel groups as a favored group, but we look at how our rules or our proposals affect all groups. And angels in particular, what we have attempted to do is, we realized that after the general solicitation rules came out, there were questions that came up about how that affected angel invest-

ing, and what we have attempted to do is, we put out staff guidance on issues that we think can be helpful—

Mrs. WAGNER. And have you received feedback on your report or your guidance that has—

Mr. HIGGINS. We have. And I think it has been favorable. I spoke last fall at an angel convention here in Washington, D.C. I spoke to the group about the things that we were doing, and I think we got very positive feedback and—

Mrs. WAGNER. So, again, regarding the JOBS Act, an unfortunate oversight left savings and loans out of these provisions. To fix these, I introduced the Holding Company Registration Threshold Equalization Act of 2013, along with Representatives Womack, Himes, and Delaney. It passed the House by an overwhelming majority of 417–4. Mr. Higgins, what is the SEC doing to fix this issue?

Mr. HIGGINS. We are currently working on the 12(g) Title V, Title VI rulemakings right now and that is an issue that is among the issues that—

Mrs. WAGNER. Any timeframe, sir?

Mr. HIGGINS. We are hoping to have a proposal out this year but—

Mrs. WAGNER. Okay. Great. Thank you.

Question, since 2008, the small business capital formation forum has recommended that the SEC change its rules to permit forward incorporation by reference in registration statements on Form S-1 by all companies. The forum said that the current rules are an impediment to capital formation and add little or nothing to the availability or quality of subsequent public information. We have had witnesses come before the committee who have crossed the ideological spectrum who have said the same thing and that change is long overdue.

What is the Division doing to remove this unnecessary impediment that adds little or nothing to investor protection?

Mr. HIGGINS. Right. We don't have any current rulemaking project on that right now. If we were to look at the question, I think what we would want to look at is forward incorporation has historically been available for companies that have had a market following for some period of time.

And so, we would want our economists to take a look at how information gets disseminated by companies that don't have as big a market following as some others. But it is an issue that we do understand.

Mrs. WAGNER. And take very seriously. I have introduced the Small Business Freedom to Grow Act which includes this recommendation and it passed our committee by a large bipartisan vote, so I am hoping it will be coming to your attention very soon.

I thank you, Mr. Chairman, for your indulgence, and I yield back.

Chairman GARRETT. I thank the gentlelady.

And now, the Chair recognizes Mr. Foster for 5 minutes.

Mr. FOSTER. Thank you.

I would like to ask a few questions about the conflict mineral disclosure rules. Although Section 1502 requires mandating disclosures by publicly traded companies of the origins of listed conflict

minerals, because of complex products and complex supply chains, many private companies that supply components to these publicly held companies are also effectively covered under the rule.

In fact, there is a private company in my district that has been grappling with the cost associated with conducting due diligence as required by this rule, and in correspondence with my office, they noted that they had been soliciting mineral information from their suppliers, both in the United States and the United Kingdom, but they have received very low response rates, and this has led them to expend many hours of employee time and many resources trying to follow up with the suppliers.

So I have several questions related to this. First, in light of the D.C. Circuit striking down a portion of the rules requiring issuers to describe certain products as having been, “not found to be conflict-free,” is there a clear definition of what would satisfy the due diligence requirements on the Form SD? Should they simply rely on their suppliers and their responses as truthful?

Is there a de minimis level of component value at which they can say, okay, we will just take your response to that phase value and not have to delve further in?

Mr. HIGGINS. The rule does not have a de minimis—

Mr. FOSTER. Okay. So that—all the way down—

Mr. HIGGINS. —aspect to—

Mr. FOSTER. And so, microscopic components in the sub-assembly have to be documented as being conflict mineral free?

Mr. HIGGINS. That is correct. It is the obligation of the public company to conduct due diligence under an internationally recognized due diligence framework to try to assess where that mineral came from.

Mr. FOSTER. Do you think that might be a useful addition to this?

Mr. HIGGINS. I am not sure. What would—

Mr. FOSTER. Just say that any component that costs less than one penny or is less than a tenth of a percent of the total value of what it is that you are supplying to a publicly held company, I—

Mr. HIGGINS. Congressman, I wasn’t at the Commission when the conflict mineral rule was being developed and adopted but I do know that there was a lot of comment back and forth on the de minimis—on whether there should be a de minimis exception and the Commission concluded at that time that there would not be consistent and that was consistent with what they believed, I think, congressional intent to be on that. So, whether that is an issue that should be revisited, I don’t really have a view.

Mr. FOSTER. Okay. Yes. And so, that is it.

And the other thing is at what point do you just take your supplier’s word for it? You could easily imagine that you got in a situation where you go down your suppliers list until you find the first one willing to lie and then that is it. What are the requirements, for example, for a privately held corporation to look behind the scenes on each one of their suppliers?

Mr. HIGGINS. Right.

Mr. FOSTER. I am calling for some clarity as to what is the definition of due diligence. At least, the companies in my district that

have contacted us on this don't feel that they know what the real definition is.

Mr. HIGGINS. Right. Well, the rule is new. Obviously, this was the first year that it was mandated, and as with any new rule-making, perhaps we will get feedback from suppliers like the other one in your district as well as other companies that will inform our taking a look at whether something can be done to provide better guidance.

Mr. FOSTER. And what are the SEC's plans for enforcement against companies whose reports are deemed to be incomplete on this?

Mr. HIGGINS. As with any new rulemaking, what we typically do is we will look at the forms, the reports that have been filed to determine whether there is any general problem, whether companies are generally not getting the rule correct, and if that is the case, we typically would issue guidance of general applicability. As to the review of individual filings if in the course of a company's Sarbanes-Oxley 3-year review, if the staff were to determine that the company had a materially incomplete filing, it would likely issue a comment.

Mr. FOSTER. Right. So you would only be acting against the publicly held company and not their private subcontractor?

Mr. HIGGINS. Correct. That is the only company which is subject to the rule.

Mr. FOSTER. Okay. I am in my last 15 seconds.

Just a quick question that you may have to follow up with me on is this issue of the calculating of the ratio of CEO pay to median income, a lot of the complexity is just—if calculating the exact median salary is in principle a pretty complicated and computer-intensive job, you need a list of all salaries which may or may not be a big issue, but if there was a—if you could get back with some other simplification, for example, that you have an answer which was accurate enough to 10 per cent in the median, if that would be a significant simplification, I would be very interested and maybe the Congress would take action there.

Mr. HIGGINS. We could get back to you on that.

Chairman GARRETT. Thank you.

Mr. Huizenga is now recognized for 5 minutes.

Mr. HUIZENGA. Thank you, Mr. Chairman. I appreciate that and I actually want to continue to explore a little bit what my colleague from Illinois was talking about because I, too, am running into manufacturers that are very much struggling with what to do and how to handle the conflict minerals part of the requirements in Dodd-Frank. And I actually would love to work with Mr. Foster and others if we can find some legislative resolution to this because, as I think he had mentioned, the D.C. Circuit Court of Appeals ruling certainly adds a fog to this whole issue.

And I am curious, in your opinion, do companies need to comply with the conflict minerals rule in light of that ruling?

Mr. HIGGINS. We think they do. A portion of the rule was struck down but a substantial portion of the rule was upheld and the Commission's process in adopting the rule was upheld. And so, the Commission made the determination that the rule which Congress

had mandated that we adopt was upheld and we needed to go forward with implementing.

Mr. HUIZENGA. I, like you, wasn't here when they wrote Dodd-Frank. I am just dealing with the echo effects of it and this is a rather large echo effect that I think is obviously well-intentioned. Nobody wants to see atrocities anywhere and this was specifically geared towards the Democratic Republic of Congo (DRC).

Will you all review the guidance and clarify it for these companies?

Mr. HIGGINS. If there is a way that we can clarify what the private suppliers' due diligence obligations are, we would be happy to take a look at that. This is the first time that I have personally heard of the issue. Again, it is the first year of implementation and we will be happy to—

Mr. HUIZENGA. And I am concerned, I guess philosophically. We are on a little bit of a slippery slope here as well using securities laws to battle societal ills here. Even Chair White had a couple of "series of questions" whether, "using the securities loss and the SEC's powers of mandatory disclosure" to accomplish what many deemed laudable goals such as improving mine safety in those kinds of things and the human rights atrocities that are there.

Is it the proper role of the SEC to go in and try to correct these things or is that—philosophically, what do you think the role is?

Mr. HIGGINS. My philosophical answer is it sort of goes back to my junior high civics class and that is when Congress passes a law, and the President signs it into law and directs an agency to adopt the rules, that agency should adopt the rule.

Mr. HUIZENGA. I got it. Okay. So you are executing your job as instructed. I understand that. I guess it is up to us and I am—in fact, I have mentioned this to the chairman as well, I think it would behoove us on this committee and I am happy to be Vice Chair of the Monetary Policy and Trade Subcommittee to go see it for ourselves.

We have had some hearings here with folks from the Congo with mixed reports, at best, as to the effectiveness of this and as to whether we are actually maybe even causing more harm to the localized economy, and I am not talking about the warlords and others who may be controlling the area. I am talking about the real people who are dependent upon those jobs and on the mining that is there.

I have not quite a minute left, and I know another one of my colleagues is talking a little bit about the pay ratio and I think that was—the quote was getting at the fairness issue. Do you believe that anywhere in this 953(b)—does it fit within the SEC's three-part mission of protecting investors, maintaining fair, orderly, and efficient markets, and facilitating capital information? Is that the job of the SEC?

Mr. HIGGINS. That is the mission of the SEC, as many people have said here today. I guess I would turn again to 953(b) as Congress directed the Commission to implement—

Mr. HUIZENGA. I know you were directed to do that but the question is, does publishing pay ratios where there is no guidance as to whether it is part-time, foreign, or contracted out to get the bathrooms clean really going to maintain fair, orderly, and efficient

markets? Facilitate capital formation? Protect investors? I am lost as to how that actually happens?

Mr. HIGGINS. I think my personal view on it, I am sorry to say, is irrelevant; the mission of the Commission is to follow the law.

Mr. HUIZENGA. I get it. And you are doing that well, and we could keep talking until the chairman notices that I am over my time. But I am rather enjoying this.

I guess I would express to my colleagues that we have a role here, and the SEC has a role here, and I am not sure that the SEC is executing that.

So thank you, Mr. Chairman. I appreciate the additional time.

Chairman GARRETT. It was such a very important discussion that was going on by the gentleman, and I believe both sides were being receptive to it, so I wanted to give you the latitude there to go on. So, thank you.

And with those extra seconds in mind, the gentleman from California is recognized. We will be looking for equally insightful comments to—

Mr. SHERMAN. One insight is that the job of the SEC is to carry out the statutory mandates that we pass in Congress that we impose on the SEC. It is not just their job to protect investors. We have assigned them through statute an effort to try to diminish the harm done by conflict minerals, for example, or to try to illuminate for this country the growing gap between CEOs and medium pay.

If tomorrow we passed a statute that because we conclude there is a surplus of green paint in this country, everything at the SEC has to be painted with green paint, then that also becomes part of their mission. Let's hope we don't have such an enormous surplus.

Speaking of the pay disclosures, when are you going to get the job done?

Mr. HIGGINS. Right. We have active rulemaking projects on all of them. With CEO pay ratio, we have a proposal out. The other ones, we are working on—

Mr. SHERMAN. When are you going to get it done?

Mr. HIGGINS. Unfortunately, I don't control the agenda. The Commission has a lot—

Mr. SHERMAN. What is your best estimate as to when it will be done?

Mr. HIGGINS. I just don't really have an estimate. We would like to get it done—I would like to get this done—

Mr. SHERMAN. You are—

Mr. HIGGINS. It is a mandate that we need to get done.

Mr. SHERMAN. Will it be done a year from now?

Mr. HIGGINS. I can't predict—

Mr. SHERMAN. Will it be done 2 years from now?

Mr. HIGGINS. I just can't predict.

Mr. SHERMAN. Ten years from now?

Mr. HIGGINS. I won't be in the job then, but I don't—

Mr. SHERMAN. But sitting where you are now is the best person to predict whether it will be done 10 years from now. Will it be done 10 years from now?

Mr. HIGGINS. Yes. I am confident of that.

Mr. SHERMAN. Nine?

Let's see. I have—well, let's focus on the accounting issue. Has your Division or the SEC in general looked at the economic harm and unfairness of the lease accounting proposal pending at the Financial Accounting Standards Board?

Mr. HIGGINS. Dealing with the FASB is the role of the Commission's Chief Accountant—

Mr. SHERMAN. Right.

Mr. HIGGINS. And the Chief Accountant doesn't report to me but I would be happy to have the Chief Accountant get back to you on what they have done on the lease accounting standards.

Mr. SHERMAN. Do you have a Chief Accountant?

Mr. HIGGINS. He has announced that he is leaving, but we still have a Chief Accountant.

Mr. SHERMAN. I know. I called over there and he wouldn't talk to me, and the reason was that he was packing his bags. So your optimism that the Chief Accountant will get back to me on that—

Mr. HIGGINS. I am sure that someone could get back to you.

Mr. SHERMAN. They did. They didn't say anything, but they did call back. The box was checked.

Okay. What happens under the conflict mineral rules if a non-public company simply lies when it is a supplier to a public company? Are they subject to any criminal penalties or anything else?

Mr. HIGGINS. Criminal penalties? I don't know the answer to that.

Mr. SHERMAN. Is there any—assuming you are really good at lying, is there any reason for a supplier not to lie and just say, no conflict minerals here?

Mr. HIGGINS. Well—

Mr. SHERMAN. If they do that, what penalties do they face—

Mr. HIGGINS. The public—

Mr. SHERMAN. —if they are non-public?

Mr. HIGGINS. The public company has an obligation to conduct a reasonable due diligence and if there are no red flags around that, I would assume the public company could—

Mr. SHERMAN. So you have to lie—

Mr. HIGGINS. —rely on that information.

Mr. SHERMAN. So if the supplier is able to lie with the effectiveness sufficient to fool the duly diligent, they are home free.

Mr. HIGGINS. I don't know what the consequences are of a private supplier lying to a public company in satisfying its diligence obligations. I can look into it, but I just don't know the answer off the top of my head.

Mr. SHERMAN. Okay. Finally, as to computerized trading, they are taking money off the table. They are not performing any service to the economy that I can ascertain. We got a flash crash, why do—what is the benefit to our society and to our markets to not having—to taking any one of several steps that would minimize this computerized trading?

Mr. HIGGINS. I don't know whether you were here for the hearing where Mr. Luparello, who is the head of the Trading and Markets Division testified, and whatever answer he gave you would be my answer because that is—it is really is in his area and not mine. I just don't—our Division doesn't deal with high frequency trading.



Mr. SHERMAN. I am looking at the SEC chart, and you are one of like 30 boxes. So it is hard to know which one of the 30 at the SEC's responsibility we are addressing here today, but it is nice to know that my part of addressing it is concluded. Thank you.

Chairman GARRETT. Indeed. Mr. Mulvaney is now recognized for 5 minutes.

Mr. MULVANEY. Thank you, and I appreciate the questions by Mr. Foster from Illinois, and Mr. Huizenga from Michigan, for taking that opportunity to remind us all that the SEC is in charge of regulating conflict minerals.

As someone who is still fairly new to the committee, and still fairly new to Congress, I hope that still strikes some people in addition to myself, that it is just patently absurd that the Securities and Exchange Commission is in charge of regulating conflict minerals.

That an entity that is supposed to protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation is in charge of making sure stuff doesn't come from Congo, a country, by the way, just ironically, that also receives taxpayer subsidies from the Export-Import Bank, another topic that we will be taking up shortly.

And for folks who follow the markets and who rightly will ask the next time that an investor is damaged or injured that markets are not fair, orderly, and efficient, or the capital formation has been somehow impaired and they ask a very reasonable question, where was the SEC, why weren't they doing their job?

The answer will be, well, they were doing their job, they were making sure that we didn't have stuff coming in from Congo. And they are doing that job because we told them that is their job, and I hope that I am not the only person who thinks that is just one of the craziest things I have heard since I have been in Congress.

It is relevant to what I want to talk to about, Mr. Higgins, because I have to take the opportunity, if I can, to talk about the JOBS Act, to talk about especially crowdfunding. It continues to sort of stick in my craw that we have rules on conflict minerals. We got those in a very timely fashion but we are now 18 months late on some of the crowdfunding rules. The Reg A-plus rules are also late and it seems like at least for some of us, the priorities are out of whack. Again, I am not blaming you, but to have conflict minerals rules before we have crowdfunding rules seems to me to be a case of misplaced priorities.

So I am going to ask you about some of the proposed rules because the SEC does have some proposed rules floating out regarding crowdfunding. And I want to dig down on some of the places where I want your opinion, sir, as to whether or not how do you think these proposals will affect capital formation; specifically it is the rule that if I am going to try and raise more than \$500,000 through crowdfunding, I have to get an audit, have those audited financial statements.

I used to run a small company. Audit and financial statements are very, very expensive. In fact, we were rarely audited and we had reviews up on audited financial statements. Do you think, sir, that requirement will positively or negatively impact the ability of small businesses to access capital through crowdfunding?

Mr. HIGGINS. It is a question that the Commission has asked in the rule proposal. Congress set the \$500,000 threshold for audited financial statements but gave the Commission the ability to change that and raise it up to a million dollars.

The Commission stopped with the \$500,000 in the proposal but asked for comment and we received comments from a variety of people—some saying, yes, \$500,000. Some people want it lowered, other people want it raised. So these are comments that we are considering as we prepare a final rule proposal.

Mr. MULVANEY. But I think you would agree with me that it would make it less likely that businesses would access crowdfunding if they have to go to the additional cost in time of having audited financial statements.

Mr. HIGGINS. I don't know that, but I do know that audited financial statements cost more than reviewed financial statements.

Mr. MULVANEY. Got it. Also, one of the proposals is that these businesses follow the generally accepted accounting principles (GAAP). Is there a similar impact there to the audited financial statements requirements?

Mr. HIGGINS. We are getting comment on that as well. I guess GAAP is now establishing a private company financial statement regime which would be different than GAAP. We are getting comment on that. I think our office Chief Accountant is helping us think through and analyze that issue. But GAAP is pretty well-known, I guess as opposed to what—the cash method or income tax or something like that, although at the lower levels, I think some of those suffice.

Mr. MULVANEY. And finally, Mr. Higgins, on the rule—the proposed rule regarding only using a single intermediary, is that something you all continue to look at as opposed to allowing businesses to use multiple intermediaries?

Mr. HIGGINS. We are getting comments on both sides of that. Some people are saying that a single intermediary focuses the protection better. Others think that it might limit the ability for companies to be able to raise money.

Mr. MULVANEY. Thank you. Since we mentioned GAAP, let me change gears on you for just a second because we had Chair White in May giving a speech explaining that she wanted to use international financial reporting standards (IFRS) more aggressively in the future, and I wonder if you have an opinion, sir, as to whether or not using the IFRS in our capital markets might create confusing situations where we sort of have two competing systems at the same time, a double GAAP so to speak.

Mr. HIGGINS. I believe the Chair's position on IFRS is that she would like to get a sense of the path forward by the end of this year, I think is what she has said publicly. And whether it causes confusion currently, foreign issuers are allowed to file under IFRS. There is no GAAP reconciliation required.

I think the Commission is committed to a high quality set of global accounting standards. If IFRS turns out to be that, I think that would probably be the direction to go. On the other hand, there is a lot of debate going on and whether that is the right direction, and I think the Commission is trying to sort through what the path forward will be for U.S. companies.

Mr. MULVANEY. Thanks, Mr. Higgins. Thanks, Mr. Chairman.

Mr. HIGGINS. Sure.

Chairman GARRETT. Mr. Lynch is recognized for 5 minutes.

Mr. LYNCH. Thank you, Mr. Chairman. I appreciate that. Thank you, Mr. Higgins, for helping the committee with this work.

I would like to ask unanimous consent to put in the record a statement by the Council of Institutional Investors relative to the oversight of the SEC's Division of Corporation Finance.

Chairman GARRETT. I understand that has already been entered.

Mr. LYNCH. I'm sorry?

Chairman GARRETT. It has already been entered into the record.

Mr. LYNCH. Thank you.

Chairman GARRETT. But with the unanimous consent, we will do it a second time.

Mr. LYNCH. Thank you, sir.

Mr. Higgins, I would like to talk a bit about the well-known seasoned issuer (WKSI) waivers. As you know, a WKSI waiver is something that the Division of Corporation Finance controls, the Director controls that.

And just to clarify, the WKSI label enables a well-known seasoned investor to use automatic shelf filing rather than going through the whole detailed filing with the SEC; automatic shelf registration, I think is what it is called. But what is problematic is that the SEC in Congress through regulation and through the laws have basically prohibited, in certain instances, companies from using that label or designation if they have been found guilty of serious felonies or in some cases misdemeanors.

And those measures are intended to protect the investors and the markets from bad actors. As I said under the Federal securities law and regulation, issuers are automatically disqualified by Congress or the SEC from claiming WKSI status when they or their subsidiaries among other factors convicted of certain felonies or misdemeanors are determined to have violated the anti-fraud provisions of the securities law.

However, in practice, the SEC frequently waives these disqualifications allowing issuers to claim the benefit of WKSI status. Since 2010, the Commission has granted at least 30 WKSI waivers, and I guess not surprisingly, 29 of those waivers went to very large financial institutions and broker-dealers.

In many cases, these issuers are receiving their second, third, even fourth WKSI waiver in less than 4 years. As SEC Commissioner Kara Stein notes in her recent dissent from the SEC's waiver for the Royal Bank of Scotland, some large firms have received more than a dozen waivers over the past several years.

One large financial firm alone in a 10-year period received 22 different waivers from the SEC. So that is problematic. I agree with Commissioner Stein's remarks that nearly every factor in the Division of Corporation Finance's revised statement on well-known seasoned issuer waivers weigh strongly, I think especially in the case of a waiver for the Royal Bank of Scotland.

The egregious conduct by the Royal Bank of Scotland was part of a widespread scheme undertaken by a number of large banks to manipulate the LIBOR rate for their own profit and the LIBOR

rate is determinant for about \$350 trillion in derivatives. It basically underpins the entire U.S. derivatives market.

So by manipulating the LIBOR, those banks were manipulating the entire U.S. derivatives market. And the manipulation of LIBOR by the Royal Bank of Scotland harmed millions of Americans, and this was at a time when our Nation was facing its worst financial crisis since the Great Depression.

We didn't get much action here in Congress over this whole scandal. I don't know how that happened. But we had very, very little attention on this committee with respect to the manipulation of the LIBOR rate.

In such situations, the SEC needs to ensure that the American people are protected from egregious conduct by financial institutions and the SEC should be penalizing the Royal Bank of Scotland for its conduct instead of granting them a waiver. And I just want you to persuade me that I am wrong here.

Mr. HIGGINS. The WKSI status that you refer to, when an issuer is convicted of a crime or an anti-fraud violation, it automatically disqualifies them from WKSI status.

The rules that the Commission adopted built in a waiver process if for good cause shown the issuer shows good cause why the waiver shouldn't apply. The focus of the inquiry is whether the conduct for which the issuer has already been punished, I mean, it is not a question that—

Mr. LYNCH. How are they punished?

Mr. HIGGINS. I think they paid a multibillion dollar—it was a significant—no, it was hundred—

Mr. LYNCH. So we can pay out of—

Mr. HIGGINS. That is what the Justice Department—

Mr. LYNCH. That is being paid in many cases by the investors. So the people who perpetuated this are not getting penalized. The investors are getting penalized with the fine and that is it?

Mr. HIGGINS. The WKSI disqualification was never considered by the Commission to be a penalty for the underlying conduct. What it was is an automatic disqualification because it called into question whether the issuer could produce reliable and accurate disclosure. It might. If the issuer could show with good cause that it didn't affect that and that conduct was unrelated to their disclosure—

Mr. LYNCH. But you have one company here 22 times. At one point, I know you are going to say it is anecdotal, but at some point, it becomes a pattern and practice.

Chairman GARRETT. And with that—

Mr. LYNCH. Thanks for your indulgence, Mr. Chairman.

And thank you, Mr. Higgins.

Mr. HIGGINS. Thanks.

Chairman GARRETT. Mr. Stivers is recognized for 5 minutes.

Mr. STIVERS. Thank you, Mr. Chairman. Thank you for being here, Mr. Higgins.

I was just looking at some speeches by some of the members of the SEC and in October of 2013, Chair White essentially talked about how increasing the disclosure regime can lead to information overload.

I looked at another speech that Commissioner Gallagher gave in July of 2013 that talked about when you require too much disclosure, it really is becoming a regulatory creep and doesn't provide real value to investors. And then a speech by Commissioner Piwowar in January of 2014 where he again expressed concerns about the continual growing disclosures and how it leads to information overload.

And then I looked at the speech you made in February maybe, or April that says, and I will quote a little bit of it, "While it may be called disclosure overload or cutting the clutter, losing the excess baggage, we can all probably agree on the need to reduce the material disclosures."

However, essentially you say that one person's meat is another person's fat. I guess my first question is, you do work for the Commissioners, right?

Mr. HIGGINS. I do.

Mr. STIVERS. Okay. So you do share their belief that there could be some information overload in the disclosure or not?

Mr. HIGGINS. I believe that there could be disclosures that investors don't find useful and the companies find burdensome. I also believe that it could go the other way. There could be information that isn't there that investors would find useful and companies may find burdensome. And the job of the Commission is to balance that.

Mr. STIVERS. Right. And so my next question is, what are you doing about it?

Mr. HIGGINS. Right.

Mr. STIVERS. How are you reaching out to figure out what disclosures are overly burdensome to companies and not useful to investors? And even to find information that would be useful to investors that is not included in disclosures, although if everybody is talking about disclosure overload and mission creep, my guess is there is a lot more that you might be requiring today that is not useful to investors as opposed to stepping this up. But what are you doing about it? How are you fixing that problem and seeking information?

Mr. HIGGINS. Right. We have reached out to a lot of—first of all, people can send an email to [disclosure@SEC.gov](mailto:disclosure@SEC.gov). They can send in their recommendations, their comments, and their thoughts about how we can get better, more effective disclosure.

We have gone out, and we have met with interested groups of investors and companies. I spent some time at a large mutual fund complex speaking with portfolio managers and equity analysts about information that they find to be useful.

And it is eye-opening, really these folks at big financial institutions want more information. They would like to see companies—

Mr. STIVERS. And big institutions have a lot of means to get their own information. Your job isn't to work for big financial institutions. Your job is to protect the investors. And so, is it your job to substitute for their own due diligence?

Mr. HIGGINS. Not at all. Our job is to make sure that investors have the accurate material information necessary to make voting and investment decisions and that is the input we are seeking.

Mr. STIVERS. Great. Keep seeking comment and information and then act. Because I do find the SEC seeks information a lot, sometimes acting slowly, and I share that frustration with—and I know you are a Commission, it is not like there is one person directing you, I get it. There is a variety of opinion but I just read three of the five Commissioners who have a fairly similar position.

But keep seeking information but then at some point, please act. I am running out of time. I do want to ask you about every year you get recommendations on capital formation from your small business capital formation commission. Tell me, how many of those have you acted on?

Mr. HIGGINS. Right. If you are referring to the small business—the government small business forum.

Mr. STIVERS. Yes, the small business forum. So have you acted on any of their recommendations?

Mr. HIGGINS. We have acted on recommendations.

Mr. STIVERS. Do you have any idea how many? Do you know the percentage?

Mr. HIGGINS. I don't, but I can—

Mr. STIVERS. You have to get back to me on that because—

Mr. HIGGINS. And a lot of those recommendations became part of the JOBS act and—

Mr. STIVERS. Right. And do you know why it became part of the JOBS act? Because the SEC didn't act on them. So, that is my push here and I have 8 seconds left. But, you have a great advisory council of small business people who are telling you the things they need and the burdensome things that are weighing on them. Please, listen to them. That is my plea to you.

Mr. HIGGINS. Right. Thank you.

Mr. STIVERS. I yield back, Mr. Chairman.

[The SEC's written response to the above question can be found on page 52 of the appendix.]

Chairman GARRETT. The gentleman yields back. Mr. Carney is recognized for 5 minutes.

Mr. CARNEY. Thank you very much, Mr. Chairman, for having this hearing. And thank you, Mr. Higgins, for coming in and helping us do our important business.

Yesterday, we had a hearing before the full Financial Services Committee with a great panel which included our former chairman and ranking member, Barney Frank. And we had a lengthy discussion about risk retention and mortgage lending securitization and mortgage lending under Section 941 of Dodd-Frank where there was a requirement at the SEC, along with the banking regulators, with HUD and with the FHFA-prescribed rules about risk retention, not less than 5 per cent of an economic interest in a material portion of that credit risk for any asset that a bank might transfer.

And, of course, you came out with a rule, the agency came out with a proposed rule in March of 2011, and then a reproposal in August of 2013. And the issue that former Chairman Frank complained about was the fact that the original statute that he described, and I have his testimony here, said that there are three categories of mortgages: those that fell below QM standards which were subject to certain legal constraints; QM mortgages which were

the minimum standards; and then QRM which were the super good quality mortgages.

And that in the repropose rule that the Commission—the agencies I should say came out basically where QM and QRM were essentially the same. Thereby, according to former Chairman Frank, taking out the risk retention provision because some of those QRM mortgages are not subject to that.

What was the thinking from the SEC's perspective of that repropose vis-a-vis risk retention in the mortgage lending space?

Mr. HIGGINS. The repropose rule proposed that QRM equal QM as the preferred approach but also offered an alternative approach which added additional features to QM in order to get to QRM, seeking comment recognizing that it was an issue of substantial concern.

Mr. CARNEY. How would you respond to former Financial Services Committee Chairman Frank's objection that the clear statutory intent was to have three categories, if you will: the non-QM lower standard; the QM minimum standard; and the QRM super quality standard? And therefore, is QRM subject to certain exceptions under the Act or under the regulation?

Mr. HIGGINS. That is a view that has been expressed not only by former Chairman Frank but by many commenters who have written in on the joint agency rule proposals. We are working through those comments. Joint agency rulemaking is an interesting process.

Mr. CARNEY. Difficult, for sure.

Mr. HIGGINS. Because they are different agencies with different missions. The Fed's mission is different than HUD's mission, which is different than the SEC's mission, and so on.

Mr. CARNEY. We will see what happens from there based on public comment.

And lastly, in my last minute-and-a-half, my friend and colleague Mr. Fincher and I worked in the last Congress on the IPO On-Ramp. It may be familiar but it was part of the JOBS act. It didn't require any rulemaking I don't think, a minimum maybe.

I wonder if you could comment on the successor or what you have heard about some of the On-Ramp provisions. But the one I am most interested in is the quiet period, if you will, prior to an emerging growth company deciding whether to go public or not.

They are able to issue reports to potential investors to gauge interest confidentially publicly and whether or not—what I have heard from companies is that it is very helpful because they don't have—

Mr. HIGGINS. Testing the water—this is the testing the waters provision?

Mr. CARNEY. Right. That is correct.

Mr. HIGGINS. Okay. Yes. This was an area that I practiced in. I was in private practice for 30 years prior to coming to the Commission.

Mr. CARNEY. Great. So you are the perfect person.

Mr. HIGGINS. So, I did lot of IPOs. Before the JOBS Act or right after the JOBS Act came in. But testing the waters started off, right, we understand people were a little skittish about it. I think part of it was that investors only have so much time and they

wanted to deal with deals that were real deals, not works in progress.

However, we have heard anecdotally that the process is being used in a lot of deals. Initially, it was used in the biotech industries but I think now it is across-the-board. And we haven't seen any problems with it and to the extent it is helpful, we think that is great.

Mr. CARNEY. And in my remaining 15 seconds, any other feedback with respect to IPO On-Ramp?

Mr. HIGGINS. The confidential filing process has worked very well.

Mr. CARNEY. Right.

Mr. HIGGINS. Companies like it, and it has worked well for us—things are working well.

Mr. CARNEY. Great. Thanks very much. Keep up the good work.

Chairman GARRETT. Thank you. The gentleman yields back. Mr. Hultgren is now recognized for 5 minutes.

Mr. HULTGREN. Thank you, Mr. Chairman. I do want to thank Director Higgins for being here.

First, I would like to focus on the lineup questions that Representative Lynch brought up, and I wonder if you can help me understand this a little bit more. Director Higgins, as you know, in 2005 the SEC undertook securities offering reforms which among other things created a new category of issuers known as the well-known seasoned issuer or WKSI.

The main purpose of creating of WKSI was to enhance flexibility in accessing capital markets. As I understand that, there are certain instances, however, where issuers that would otherwise be considered WKSI can become ineligible and request that the Commission review their applications to grant a waiver so that the entity can once again gain WKSI status. Is this correct?

Mr. HIGGINS. Correct.

Mr. HULTGREN. Once the request is made for a waiver, does the Commission just rubberstamp an approval on the request and call it a day?

Mr. HIGGINS. Not at all.

Mr. HULTGREN. Conversely, does the Commission just categorically deny all waiver requests?

Mr. HIGGINS. The Commission doesn't—typically, they come in to the Division of Corporation Finance. We have been delegated authority from the Commission to act on the waivers.

And they come in, we talk informally with companies. Companies that we talk to informally that we don't believe would qualify for a waiver because they haven't shown good cause, they may not even come in and make a request.

Mr. HULTGREN. So it sounds to me like there is a process in place through which the Commission can consider on a case-by-case basis whether to approve or deny a waiver request. I wonder if you could walk through in a little more detail what that process is once the waiver request is received by you and your staff. What considerations do you give that request?

Mr. HIGGINS. What typically happens is there is a phone call first that comes in. Our Office of Enforcement Liaison speaks with the company about the particular facts and circumstances. And to un-



derstand better whether it is totally out of the question that they would get a waiver or whether they would present a plausible case.

If they think it is worth presenting a case, the company would submit a letter where they would focus on the factors that we lay out in our public guidance when we will grant WKSJ waivers and they will put their case forward. At that point, we will go back and forth on the letter with them, ask them questions about it.

And if we are satisfied that they have made the case, we would recommend granting a waiver. The Commission can always decide to take the authority—to decide it on its own and a case where they have done that, the Royal Bank of Scotland is a good example. But we do have delegated authority, and we would grant the waiver if we believe they met the applicable standard.

Mr. HULTGREN. Thank you. So it sounds like it is a thoughtful process and not something—to me it seems it was being characterized to something different because I hear more sounds like it is a process that does work.

Switching gears a little bit, the SEC has had an important three-part core mission: to protect the investors; to maintain fair, orderly, and efficient markets; and to facilitate capital formation. Certainly, a key component of this mission is ensuring that investors can access a wide variety of transparent investment options.

I would like to talk about the SEC's definition of accredited investor. This determines which investors, those deemed sophisticated, have access to a wider variety of investment options. Unfortunately, I think this definition has not been significantly updated since it was first promulgated back in 1982.

While this issue may be decided in Washington, it has a very significant impact on Main Street. A newer definition of accredited investor will not only hurt potential investors in my district but it will also cut off small businesses in my district for much needed potential sources of capital.

Thankfully, the SEC is reviewing the definition of accredited investor, and I am hopeful it will take the opportunity to expand this definition. While I am thankful that the SEC takes its mission to protect investors very seriously, I am also hopeful that it will recognize that today's investor has access to a wider variety of information that was not even available 10 years ago.

So my question, Director Higgins, is as follows: Linking the definition of accredited investor purely to income network is an antiquated and counterproductive measurement. As you may be aware, the United Kingdom recently added two additional ways that maybe an accredited investor, whereby a person who does not meet the income network requirements, will take a test or show through education or advanced degree that they would be able to assume the risk involved in investing a non-public securities.

I wonder, is the Division considering an educational component as you begin to update the definition of an accredited investor?

Mr. HIGGINS. We are, as part of our review of the accredited investor definition.

Mr. HULTGREN. So you are looking at that; you expect there will be some changes there?

Mr. HIGGINS. It is up to the Commission to make changes, but we are definitely looking at it and it will be part of our discussion that will be part of our report.

Mr. HULTGREN. Good. And there is an understanding or recognition of how this does impact Main Street and our constituents as well, and how very different access information is now than it has ever been before?

Mr. HIGGINS. Again, we will get comments, I am sure, on both sides of the issue, but we do understand the importance.

Mr. HULTGREN. Again, thank you for being here. My time has expired. I yield back.

Chairman GARRETT. Thanks. The gentleman yields back.

Mr. Fincher is now recognized.

Mr. FINCHER. Thank you.

Chairman GARRETT. The gentleman will have the last word.

Mr. FINCHER. Thank you, Mr. Chairman. I appreciate the willingness of the chairman to allow me to participate in today's hearing.

Just a couple of questions to wrap up—I am going to echo what my good friend, Mr. Carney talked about. He and I did have in the JOBS Act the last time, the On-Ramp Provision in that bill. JOBS, J-O-B-S, which is what is super important in getting the economy running again, people working, that is how we produce revenue in this country.

And just a few minutes ago, my good friend, I am glad he brought up Ex-Im Bank that is a key part of the process and reforming it, making it more transparent accountable and it is all about jobs in our districts is what is important.

But back to specific questions, former SEC Chairman Schapiro attempted to water down the JOBS Act that was passed in the House in 2012, and the President ultimately signed into law. I hear many SEC staffers do not like the JOBS Act possibly because it was not invented at the SEC.

And because Congress had to act to help small companies and entrepreneurs access the capital markets more effectively, do you believe that the SEC should exhibit the same zeal, sustained effort, and enthusiasm when implementing the JOBS Act that it has done with Dodd-Frank?

Mr. HIGGINS. I think that we should implement it faithfully in accordance with our mission. Absolutely.

Mr. FINCHER. Do you feel that some staffers have taken the opinion that they really turn the cold shoulder to the JOBS Act?

Mr. HIGGINS. None have expressed it to me, Congressman.

Mr. FINCHER. Okay. And then lastly, what is the SEC's capital formation agenda outside of the JOBS Act? Are there specific rule changes the SEC is considering that would be helpful to small companies looking to raise capital and that would distinguish them from larger companies?

Mr. HIGGINS. As we are often reminded, we still have some wood to chop on the JOBS Act front. We are focused on getting that done. Our Office on Small Business Policy in the Division is open for business. We answer more than a thousand requests each year from small businesses and other market participants who are interested in small business capital raising.

So we are available to try to provide guidance on the rules that have already been adopted so that people can have some certainty in how they are applied and make it easier and more cost-effective to do. So, the Division is committed to this small business capital formation.

Mr. FINCHER. With that, I yield back, Mr. Chairman. Thank you again for your patience.

Chairman GARRETT. It was well worth the wait. I think everyone would agree with that. No one is commenting.

Seriously though, Mr. Higgins, we do appreciate your time and your work at the Commission.

The Chair notes that some Members may have additional questions for this witness, which they may wish to submit in writing. Without objection, the hearing record will remain open for 5 legislative days for Members to submit written questions to this witness and to place his responses in the record. Also, without objection, Members will have 5 legislative days to submit extraneous materials to the Chair for inclusion in the record.

And with that, there being no further business before the subcommittee, I thank you once again, and this hearing is now adjourned. Thank you.

[Whereupon, at 11:59 a.m., the hearing was adjourned.]



# **A P P E N D I X**

July 24, 2014

**Testimony on “Oversight of the SEC’s Division of Corporation Finance”**

**By Keith Higgins, Director  
Division of Corporation Finance  
U.S. Securities and Exchange Commission**

**Before the  
United States House of Representatives Committee on Financial Services  
Subcommittee on Capital Markets and Government Sponsored Enterprises**

**July 24, 2014**

Chairman Garrett, Ranking Member Maloney, and Members of the Subcommittee:

Thank you for inviting me to testify today on behalf of the U.S. Securities and Exchange Commission (Commission) about the Division of Corporation Finance’s (Division) activities and responsibilities.

The mission of the Commission is to protect investors, maintain fair, orderly and efficient markets, and facilitate capital formation. The Division promotes this mission by overseeing the agency’s review of company disclosure to the investing public and seeking to ensure that investors have access to materially complete and accurate information upon which to make voting and investment decisions. The Division also promotes this mission by reviewing registered securities transactions and administering the regulations under which exempt offerings are conducted.

The Division’s authority is derived primarily from the Securities Act of 1933 and the Securities Exchange Act of 1934 (Exchange Act).

While not descriptive of the full scope of the Division’s initiatives and mandates, generally the Division carries out its mission in three areas: selectively reviews company filings, provides interpretive advice to market participants and the public about the securities laws and corresponding regulations, and makes rulemaking recommendations to the Commission on matters within the Division’s expertise. Below is an overview of those activities.

**Review of Filings**

The Division regularly and systematically reviews the disclosures and financial statements of reporting companies to monitor and enhance compliance with disclosure and accounting requirements. The Sarbanes-Oxley Act of 2002 requires the Commission to review the disclosures and financial statements of companies reporting under the Exchange Act at least once every three years and more frequently where circumstances warrant. In addition to these mandated reviews, the Division selectively reviews registration statements and other filings made for public offerings, business combination transactions, and proxy solicitations. The Division’s staff has broad discretion to select filings for review. While the Division does not

publicly disclose detailed information about the selective review criteria, they include both transaction and company matters as well as matters relating to shareholder rights.

The Division consistently exceeds the mandated Sarbanes-Oxley Act requirement by reviewing the disclosure of many companies more often than once every three years. In so doing, we remain focused on the financial statements and disclosures of the approximately 2,500 companies that comprise nearly 98% of total market capitalization. During fiscal 2013, the Division reviewed the filings of more than 4,500 reporting companies. Based upon our work in the first nine months of fiscal 2014, I expect our reporting company review statistics will be comparable this year.

The staff members conducting filing reviews are assigned to one of thirteen offices and have specialized industry, accounting, and disclosure expertise. In the course of a filing review, the Division's staff will conduct an evaluation of company disclosure and will, as appropriate, issue comments to elicit better compliance with applicable disclosure requirements. In response to staff comments, a company may amend its financial statements or other disclosures to provide additional or enhanced information in the filing that is subject to the review or, in some instances, may provide improved disclosure in future filings. A company may also provide supplemental information so the staff can better understand the company's disclosure decisions. The Division coordinates with other offices and divisions within the Commission on complex or interconnected issues that arise within these reviews. Where appropriate, the Division refers matters to the Commission's Division of Enforcement.

To increase the transparency of the filing review process, after the Division completes a filing review the comment letters and company responses to those letters are made public on the SEC website. Each comment letter is designed to elicit more effective disclosure based on the specific facts and circumstances of the company and should not be interpreted as generally applicable to all companies. The Division also continues to look at ways to improve the quality and consistency of our comments as well as the overall effectiveness of our filing review process.

#### **Interpretive Advice**

The Division also provides advice to market participants and the public through interpretive releases, staff legal and accounting bulletins, the Division's financial reporting manual, no-action and interpretive letters, compliance and disclosure interpretations, and staff disclosure guidance topics. All of these are available on the Commission's website. In addition, the Division provides responses to thousands of telephone and e-mail inquiries from investors, companies, and other market participants. In addition, each year the Division responds to over 400 no-action letter requests, including over 300 requests relating to shareholder proposals.

#### ***Proxy Advisory Firm Guidance***

A recent example of the interpretive advice the Division provides is a staff legal bulletin on proxy advisory firms issued last month along with the Commission's Division of Investment Management. Proxy advisory firms participate in the proxy process by, among other things,

assisting institutional investors and investment advisers in analyzing and making voting recommendations on the various matters that are presented for shareholder approval. The Commission sought information about the role of proxy advisory firms in the proxy process in a concept release in 2010 and at a public roundtable that the Commission held last December. The staff legal bulletin issued on June 30, 2014 provides guidance on the availability and requirements of two exemptions from the federal proxy rules that are often relied upon by proxy advisory firms. It also provides guidance about investment advisers' responsibilities under the Investment Advisers Act of 1940 in voting client proxies and retaining proxy advisory firms.

### **Rulewriting**

The Division also recommends to the Commission new rules or changes to existing rules and, in doing so, collaborates with staff from across the agency, including staff from the Division of Economic and Risk Analysis. The Division's recent rulewriting activities have focused primarily on implementation of the mandatory rulemaking provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) and the Jumpstart Our Business Startups Act (JOBS Act). These rulemakings have involved a substantial effort, which I will briefly summarize.

### ***Dodd-Frank Rulemaking***

Since the passage of the Dodd-Frank Act, the Division has been involved in numerous rulemakings the Commission has adopted, including, among others, final rules on revising the definition of "accredited investor" to exclude the value of a person's primary residence, say-on-pay and say-on-frequency votes for executive compensation, disclosures about representations and warranties and asset-level review of asset-backed securities, compensation committee listing standards and disclosure, disqualification of felons and other bad actors from certain offerings, and specialized disclosure related to mine safety and conflict minerals. Most recently, the Division made recommendations for two rule proposals that the Commission voted to publish for public comment:

- *Credit Risk Retention.* The Commission is working with multiple federal regulators to jointly develop risk retention rules, as required by Section 941 of the Dodd-Frank Act. These rules will address the appropriate amount, form, and duration of required risk retention for securitizers of asset-backed securities. In March 2011, the Commission joined its fellow financial regulators in proposing rules to implement Section 941 and, after receiving and reviewing extensive public comment, in August 2013 re-proposed these rules with several significant modifications. The staff currently is considering the numerous comments received on the re-proposal and working with the other agencies' staff in developing appropriate recommendations for a final rule.
- *Pay Ratio Disclosure.* As required by Section 953(b) of the Dodd-Frank Act, in September 2013 the Commission proposed rules that would amend existing executive compensation rules to require public companies to disclose the ratio of the compensation of a company's chief executive officer to the median compensation of its employees. The Commission has received over 128,000 comment letters on the proposal, including



more than 950 unique comment letters. Division staff is carefully considering those comments and is preparing recommendations for the Commission for a final rule.

The Division, along with other Commission staff and the Commission, also continues work to finalize rules relating to the offering process, disclosure, and reporting for asset-backed securities. Further, the Division continues to work to implement provisions of the Dodd-Frank Act relating to executive compensation matters and payments by resource extraction issuers. Finally, the Division and other Commission staff currently are conducting a review of the accredited investor definition, as mandated by Section 413 of the Dodd-Frank Act.

#### ***JOBS Act Rulemaking***

The Division also is responsible for preparing recommendations on most of the Commission mandates under the JOBS Act, and rulewriting teams in the Division have been working to complete these mandates in collaboration with other Commission staff.

- In July 2013, the Commission adopted the final rules under Title II of the JOBS Act to allow general solicitation and general advertising for offers and sales made under Rule 506, provided that all securities purchasers are accredited investors and issuers take reasonable steps to verify their status. The rules became effective in September 2013. At the same time it adopted these rules, the Commission issued a rule proposal designed to enhance our ability to assess the development of market practices in Rule 506 offerings and address investor protection concerns that may arise with the use of general solicitation by issuers. The Commission has received over 860 comment letters on the proposal, including more than 550 unique comment letters, and the Division is working on recommendations for the Commission.
- In October 2013, the Commission proposed rules to implement Title III of the JOBS Act to provide a new exemption for the offer and sale of securities through crowdfunding, an evolving method to raise capital using the Internet. The Commission has received over 300 comment letters and the Division is preparing recommendations for the Commission on final rules.
- In December 2013, the Commission proposed rules to implement Title IV that would build upon existing Regulation A, which is an exemption from registration for small offerings of securities, to enable companies to offer and sell up to \$50 million of securities within a 12-month period. The Commission has received over 100 comment letters and the Division is preparing recommendations for the Commission on final rules.
- The Division also is preparing recommendations for the Commission to implement the changes made by Titles V and VI with regard to the thresholds for registration and deregistration under Section 12(g) of the Exchange Act, which were effective immediately upon enactment of the JOBS Act.

### **Study and Review of Public Company Disclosure Effectiveness**

Over the years, the Commission and its staff have undertaken efforts to modernize, simplify, and otherwise make disclosure more effective. In December 2013, as required by Title I of the JOBS Act, Commission staff submitted to Congress a report in which the staff presented its review of Regulation S-K. The report described the historical development of the current disclosure regime, and recommended further efforts to study the disclosure rules to determine how the rules may be modernized, made more effective, and simplified to reduce the costs and other burdens for emerging growth companies, while simultaneously improving the readability and navigability of disclosure documents for investors.

Following the issuance of the report, Chair White directed the staff to develop specific recommendations for the Commission's consideration to update the rules in Regulations S-K and S-X that specify what a company must disclose in its filings. The Division is leading the Commission staff's efforts in this regard. The goal is to comprehensively review the requirements and make recommendations on how to update them to facilitate timely, material, and more meaningful disclosure by companies to their shareholders. As part of this review, the Division will consider ways to enhance the presentation and communication of information to shareholders, including how the use of technology can play a role in facilitating shareholders' access to information. Initially, the Division is focusing its review on the business and financial disclosures required by periodic and current reports, including Forms 10-K, 10-Q, and 8-K. As part of this review, staff members are coordinating with the Financial Accounting Standards Board to identify ways to improve the effectiveness of disclosures in corporate financial statements and to minimize duplication with other existing disclosure requirements. Subsequent phases of the project will include compensation and governance information included in proxy statements.

A key component of the Division's review includes public outreach. The staff is seeking input from a broad range of companies, investors, and other market participants on how to improve disclosure and make it more effective and meaningful for investors.

### **Conclusion**

Thank you again for inviting me to discuss the Division's activities and responsibilities. I also would like to emphasize that the overview that I have shared with you today does not fully capture the tremendous commitment of the staff of the Division to our mission of investor protection and capital formation. I am happy to answer your questions.



Via Hand Delivery

July 23, 2014

The Honorable Scott Garrett  
Chairman  
Subcommittee on Capital Markets and Government Sponsored Enterprises  
Committee on Financial Services  
2129 Rayburn House Office Building  
Washington, DC 20515

The Honorable Carolyn B. Maloney  
Ranking Member  
Subcommittee on Capital Markets and Government Sponsored Enterprises  
Committee on Financial Services  
B301-C Rayburn House Office Building  
Washington, DC 20515

Re: July 24, 2014, Hearing entitled, "Oversight of the SEC's Division of Corporation Finance"<sup>1</sup>

Dear Mr. Chairman and Ranking Member Maloney:

I am writing on behalf of the Council of Institutional Investors (Council), a nonprofit association of employee benefit plans, foundations and endowments with combined assets under management exceeding \$3 trillion. Our member funds include major long-term shareowners with a duty to protect the retirement savings of millions of American workers.<sup>2</sup>

We applaud the Subcommittee for holding the above referenced hearing. As the Subcommittee is well aware, Council members and many other market participants rely, in significant part, on the U.S. Securities and Exchange Commission (SEC or Commission) and its Division of Corporation Finance (Division) "to ensure that investors are provided with material information in order to make informed investment decisions, both when a company initially offers its securities to the public and on an ongoing basis as it continues to give information to the marketplace."<sup>3</sup> With that important responsibility in mind, we respectfully offer a brief summary of our views on the four issues that we understand the Subcommittee plans to examine at tomorrow's hearing.

<sup>1</sup> Memorandum from FSC Majority Staff to Members of the Committee on Financial Services 1 (July 21, 2014), [http://financialservices.house.gov/uploadedfiles/072414\\_cm\\_memo.pdf](http://financialservices.house.gov/uploadedfiles/072414_cm_memo.pdf).

<sup>2</sup> For more information about the Council of Institutional Investors (Council) and our members, please visit the Council's website at [http://www.cii.org/about\\_us](http://www.cii.org/about_us).

<sup>3</sup> *About the Division*, Div. of Corp. Fin., U.S. Sec. Exch. Comm'n, [http://www.sec.gov/corpfin/U8fhv\\_IdUYM](http://www.sec.gov/corpfin/U8fhv_IdUYM) (last modified, Apr. 29, 2014).

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## 1. Overview of Issuer Disclosure

The Council supports the Division's comprehensive review of the SEC's rules governing public company disclosure.<sup>4</sup> As the primary users of SEC required disclosures, long-term institutional investors generally agree that the overarching goal of the Division's disclosure effectiveness project should be to increase the "the quality and usefulness of registrants' disclosures to investors."<sup>5</sup> Thus, our continuing support for the project is contingent on the goal not being usurped by other potentially conflicting goals, including that of "reducing the volume of disclosures."<sup>6</sup> We look forward to providing the SEC with input on any recommendations that may result from this laudable project.

## 2. Rulemakings Mandated by Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank)

Four years ago, with the passage of Dodd-Frank, the U.S. Congress and the administration took a significant step forward in helping to restore trust in the U.S. financial markets and strengthen investor protections. We agree with the recent statement by Eugene Ludwig, founder and CEO of Promontory Financial Group and the former Comptroller of the Currency, that while imperfect, Dodd-Frank "has made the system safer and more stable."<sup>7</sup>

Council members continue to strongly support the effective implementation and active enforcement of the investor protections afforded in Dodd-Frank.<sup>8</sup> Despite the lack of independent and adequate funding,<sup>9</sup> the SEC and the Division should be commended for the progress that has been made to-date in implementing 42 of the 95 Dodd-Frank rulemaking requirements assigned to the Commission.<sup>10</sup> Far too many important implementing rules, however, have yet to be finalized or even proposed.<sup>11</sup>

<sup>4</sup> See, e.g., Letter from Jeff Mahoney, General Counsel, Council, to Mr. Vikash Mohan, Program Analyst, Office of Financial Management, SEC 1 (Mar. 11, 2014) [hereinafter Vikash Letter], [http://www.cii.org/files/issues\\_and\\_advocacy/correspondence/2014/03\\_11\\_14\\_CII\\_letter\\_to\\_SEC\\_strategic\\_plan.pdf](http://www.cii.org/files/issues_and_advocacy/correspondence/2014/03_11_14_CII_letter_to_SEC_strategic_plan.pdf).

<sup>5</sup> U.S. Sec. & Exch. Comm'n, Strategic Plan, Planning for the Future, Fiscal Years 2014-2018, Draft for Comment 7 (2014), available at <http://www.sec.gov/about/sec-strategic-plan-2014-2018-draft.pdf>.

<sup>6</sup> Keith F. Higgins, Director, Div. of Corp. Fin., Disclosure Effectiveness: Remarks Before the American Bar Association Business Law Section Spring Meeting 2 (Apr. 11, 2014), <http://www.sec.gov/News/Speech/Detail/Speech/1370541479332#U8miLvdXzc>.

<sup>7</sup> Melanie Waddell, Bipartisan Pol'y Ctr., 20 Ways to Improve Dodd-Frank Act, ThinkAdvisor 1 (July 15, 2014), <http://www.thinkadvisor.com/2014/07/15/20-best-ways-to-fix-dodd-frank-act>.

<sup>8</sup> See, e.g., Vikash Letter, *supra* note 4, at 2.

<sup>9</sup> Melanie Waddell, at 5 (recommendation of the Bipartisan Policy Center that the U.S. Securities and Exchange Commission ("SEC") be given "the resources necessary to implement financial reform and make them less susceptible to political pressures by establishing the independent funding sources . . . and removing them from the congressional appropriations process").

<sup>10</sup> Davis Polk & Wardwell LLP, Dodd-Frank Progress Report: Four Year Anniversary Report 4 (July 18, 2014), available at

[file:///C:/Users/Jeff.Mahoney/US/Downloads/07.18.14.Dodd\\_Frank\\_Progress.Report%20\(2\).pdf](file:///C:/Users/Jeff.Mahoney/US/Downloads/07.18.14.Dodd_Frank_Progress.Report%20(2).pdf).

<sup>11</sup> *Id.* (indicating that 18 rulemaking proposals assigned to the SEC have not yet been proposed).

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We note that it has been well established that a key cause of the financial crisis was a failure of corporate governance.<sup>12</sup> Congress responded by including in Subtitles E and G of Title IX of Dodd-Frank several measures designed to reform the governance practices of public companies.<sup>13</sup>

Many of the corporate governance provisions contained in Dodd-Frank are generally consistent with Council-membership-approved best practices.<sup>14</sup> Moreover, many of the provisions are generally consistent with the recommendations of the Investors' Working Group in its seminal report on the financial crisis, *U.S. Financial Regulatory Reform: The Investor's Perspective*,<sup>15</sup> which Council members endorsed.<sup>16</sup>

In light of the clear linkage between the financial crisis and need for corporate governance reforms, we believe the Commission and the Division should prioritize their future rulemakings. More specifically, future rulemakings should be focused on proposing and adopting rules that implement the outstanding corporate governance provisions of Dodd-Frank in a high quality and effective manner that meets investors' needs.

Of the remaining Dodd-Frank corporate governance provisions that have yet to be adopted or proposed, we are particularly concerned about the pending proposed rule on disclosure of pay for performance required by Section 953(a) of Dodd-Frank.<sup>17</sup> We note that the language and legislative history of Section 953(a) indicates that the purpose of the provision is to provide investors with more quantitative information about incentive pay that would assist the market in analyzing and understanding the relationship between executive compensation programs and company performance.<sup>18</sup> Consistent with the language and intent, we would support an implementing rule that provides

<sup>12</sup> See, e.g., Fin. Crisis Inquiry Comm'n, *The Financial Crisis Inquiry Report xviii-xix* (Jan. 2011) ("We conclude dramatic failures of corporate governance . . . were a key cause of this crisis."), [http://fcic-static.law.stanford.edu/cdn\\_media/fcic-reports/fcic\\_final\\_report\\_full.pdf](http://fcic-static.law.stanford.edu/cdn_media/fcic-reports/fcic_final_report_full.pdf).

<sup>13</sup> Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203 §§ 951-957, 971-972 (July 21, 2010), <http://www.gpo.gov/fdsys/pkg/PLAW-111publ203/html/PLAW-111publ203.htm>.

<sup>14</sup> Council of Institutional Investors, *Corporate Governance Policies* §§ 2.4, 2.5, 3.2, 3.7, 5.1, 5.2, 5.5 & 5.8, available at [http://www.cii.org/files/ciicorporategovernancepolicies/07\\_08\\_14\\_corp\\_gov\\_policies.pdf](http://www.cii.org/files/ciicorporategovernancepolicies/07_08_14_corp_gov_policies.pdf) (updated May 9, 2014).

<sup>15</sup> Investors' Working Group, *U.S. Financial Regulatory Reform: The Investor's Perspective* 22-23 (July 2009), available at [http://www.cii.org/files/issues\\_and\\_advocacy/dodd-frank\\_act/07\\_01\\_09\\_iwg\\_report.pdf](http://www.cii.org/files/issues_and_advocacy/dodd-frank_act/07_01_09_iwg_report.pdf).

<sup>16</sup> Following its issuance, the Investors' Working Group ("IWG") report was reviewed and subsequently endorsed by the Council's board and membership. For more information about the IWG, visit the Council's website at [http://www.cii.org/investors\\_working\\_group](http://www.cii.org/investors_working_group).

<sup>17</sup> See, e.g., Letter from Jeff Mahoney, General Counsel, Council, to Keith F. Higgins, Director, Div. of Corp. Fin. 2 (Aug. 16, 2013) [hereinafter August Letter], [http://www.cii.org/files/issues\\_and\\_advocacy/correspondence/2013/08\\_16\\_13\\_cii\\_letter\\_to\\_sec\\_pay\\_vs\\_performance.pdf](http://www.cii.org/files/issues_and_advocacy/correspondence/2013/08_16_13_cii_letter_to_sec_pay_vs_performance.pdf).

<sup>18</sup> See, e.g., S. Rep. No. 111-176, at 135 (Apr. 30, 2010), [www.banking.senate.gov/public\\_files/Committee\\_Report\\_S\\_Rept\\_111\\_176.pdf](http://www.banking.senate.gov/public_files/Committee_Report_S_Rept_111_176.pdf).

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additional quantitative information illustrating the “relationship between executive compensation actually paid and the financial performance of the issuer . . . .”<sup>19</sup>

Our concern with the pending rulemaking is that it is our understanding that the Division may propose, at the request of some issuers, changes to the information currently required to be disclosed in the issuer’s Summary Compensation Table.<sup>20</sup> Such changes would not only be inconsistent with the language and intent of Section 953(a), but would be in direct conflict with the views of many investors who generally support and find useful the information presently required to be disclosed in the Summary Compensation Table.<sup>21</sup>

More broadly, we are also concerned that delays in the completion of the Commission’s implementation of Dodd-Frank are deferring other necessary post-Dodd-Frank rulemakings. For example, over the past year the Council has requested that the Commission consider pursuing rulemaking on the following three proxy-related issues of great interest to Council members: preliminary proxy information, universal proxy cards and director compensation arrangements.<sup>22</sup> Despite our repeated requests, the Commission has failed to propose rulemaking on any of the three issues, indicating that further consideration of our requests is dependent, at least in part, upon completing “its statutorily-mandated rulemakings.”<sup>23</sup>

### 3. Rulemakings Mandated by Jumpstart Our Business Startups Act (JOBS Act)

While it is presently unclear to us whether the JOBS Act will ultimately benefit long-term investors and the U.S. capital markets, we continue to support the Commission’s efforts to complete the implementation of the JOBS Act’s rules and regulations.<sup>24</sup> As indicated, we are hopeful that completion of the implementation of Dodd-Frank and the JOBS Act will free-up the Commission and the Division to pursue other rulemakings that are of high-priority to Council members.

<sup>19</sup> Pub. L. No. 111-203 § 953(a).

<sup>20</sup> See, e.g., August Letter, *supra* note 17, at 2-3.

<sup>21</sup> *Id.*

<sup>22</sup> See, e.g., Letter from Jeff Mahoney, General Counsel, Council, to Keith F. Higgins, Director, Div. of Corp. Fin. 1-5 (May 22, 2014),

[http://www.cii.org/files/issues\\_and\\_advocacy/correspondence/2014/05\\_22\\_14\\_letter\\_to\\_SEC.pdf](http://www.cii.org/files/issues_and_advocacy/correspondence/2014/05_22_14_letter_to_SEC.pdf).

<sup>23</sup> See Letter from Keith F. Higgins, Director, Div. of Corp. Fin., to Jeff Mahoney, General Counsel, Council 2 (June 25, 2014),

[http://www.cii.org/files/issues\\_and\\_advocacy/correspondence/2014/06\\_25\\_14\\_SEC\\_response.PDF](http://www.cii.org/files/issues_and_advocacy/correspondence/2014/06_25_14_SEC_response.PDF).

<sup>24</sup> See, e.g., Vikash Letter, *supra* note 4, at 7.

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#### 4. Review of Proxy Advisory Industry

The Council is generally supportive of the SEC staff's recently issued guidance on the proxy advisory industry (Guidance).<sup>25</sup> We note that in connection with the Subcommittee's June 5, 2013, hearing on issues relating to the industry the Council submitted a statement that included the following recommendation:

We do not believe that the SEC's rules, or interpretations thereof, require investment advisers to vote all proxies. We, however, recognize that there may be confusion regarding this issue. We, therefore, believe SEC Staff interpretative guidance would be helpful.<sup>26</sup>

Consistent with our recommendation, the Guidance clarifies that investment advisers are not required to vote every proxy.<sup>27</sup> The Guidance also provides other useful clarifications that we believe are generally consistent with existing requirements under the federal proxy rules and best practices in the industry.<sup>28</sup>

Finally, we believe that the Guidance is generally sufficient to address legitimate issues that have been raised about the proxy advisory industry. Thus, our view is that the Commission and Division should not allocate further limited resources to additional industry guidance or rulemaking at this time, particularly in light of the many other issues, including those described in this letter, that are of far greater importance to investors and the U.S. capital markets.

\* \* \* \*

<sup>25</sup> Sec. & Exch. Comm'n, Proxy Voting: Proxy Voting Responsibilities of Investment Advisers and Availability of Exemptions from the Proxy Rules for Proxy Advisory Firms, Staff Legal Bulletin No. 20, at 1-7 (June 30, 2014), <http://www.sec.gov/interps/legal/cfsib20.htm>.

<sup>26</sup> *Examining the Market Power and Impact of Proxy Advisory Firms: Hearing Before the H. Subcomm. on Cap. Markets and GSEs of the Comm. on Fin. Servs.*, 113<sup>th</sup> Cong. 4 (June 5, 2013) (statement of Ann Yerger, Executive Director, Council), [http://www.cii.org/files/publications/misc/06\\_05\\_13\\_cii\\_proxy\\_advisor\\_hearing\\_submission\\_ann\\_yerger.pdf](http://www.cii.org/files/publications/misc/06_05_13_cii_proxy_advisor_hearing_submission_ann_yerger.pdf).

<sup>27</sup> See Proxy Voting at 2.

<sup>28</sup> *Id.* at 1-7.

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We appreciate the opportunity to provide input to the Subcommittee in advance of your hearing. Should you have any questions or require any additional information about the Council's views on this, or any other, matter please feel free to contact me at 202.261.7081 or [jeff@cii.org](mailto:jeff@cii.org).

Sincerely,

A handwritten signature in cursive script, reading "Jeff Mahoney".

Jeff Mahoney  
General Counsel

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UNITED STATES HOUSE OF REPRESENTATIVES COMMITTEE ON FINANCIAL SERVICES  
SUBCOMMITTEE ON CAPITAL MARKETS AND GOVERNMENT SPONSORED ENTERPRISES  
TESTIMONY ON "OVERSIGHT OF THE SEC'S DIVISION OF CORPORATION FINANCE"

QUESTION FOR THE RECORD  
REPRESENTATIVE ROBERT HURT

Director Higgins, the SEC staff was very helpful to Rep. Delaney and me in crafting H.R. 3209, the College Savings Enhancement Act. Our bipartisan legislation would update the definitions for accredited investors and qualified institutional buyers to include state-run prepaid 529 plans. These plans play an important role for families saving for future college expenses.

Do you think that these plans are suited to be considered QIBs and AIs similar to other plans such as state-run pensions?

**Response:**

The staff of the Division of Corporation Finance has met with representatives of several state-run Section 529 plans to discuss whether state-run prepaid Section 529 plans fit in the accredited investor definition and the qualified institutional buyer (QIB) definition. These discussions have been productive and helpful to us.

Currently, the Commission staff, including staff from the Division of Corporation Finance and the Division of Economic and Risk Analysis, is conducting a comprehensive review of the accredited investor definition. For entities, the current definition relies on a list of enumerated entity types, such as corporations, business trusts and employee benefits plans, all of which must have at least \$5 million in assets. We understand that some Section 529 plans do not fit within any of the enumerated types of entities, and thus cannot qualify as accredited investors. Among the issues being considered as part of this review is whether the definition should be revised to include entities such as state-run prepaid Section 529 plans. As this review is not yet complete, I cannot offer definitive thoughts on this question. I do appreciate the view articulated by some that, when it comes to evaluating investment opportunities, the form of entity in which the \$5,000,000 in total assets is held may not be the relevant factor. The staff is assessing the merits of that view as well as investor protection concerns that may arise if these plans are included in the definition. As we continue with our analysis, we will continue to welcome input from interested parties.

The QIB definitions for entities in large part tracks the accredited investor entity definitions, the primary difference being that QIBs must own and invest on a discretionary basis at least \$100 million in securities of unaffiliated issuers. The form of entity for QIBs therefore may raise the same issues as it does in the accredited investor definition. As such, I expect that the findings of the staff's review of the accredited investor definition, including whether to include entities such as state-run prepaid Section 529 plans in the definition, would be relevant to QIBs as well.

**QUESTION FOR RECORD**  
**REPRESENTATIVE STEVE STIVERS**  
**SEC GOVERNMENT-BUSINESS FORUM ON SMALL BUSINESS CAPITAL FORMATION**

**How many of the recommendations generated from the SEC Government-Business Forum on Small Business Capital Formation have been acted on? (page 78 of transcript)**

The annual SEC Government-Business Forum on Small Business Capital Formation (the "Forum") focuses on the capital formation concerns of small businesses. Each year, participants at the Forum develop a set of recommendations with the goal of improving the environment for small business capital formation. These recommendations are valuable to the SEC as we work to facilitate capital formation by small businesses.

Participation in the Forum is open to any interested member of the public. Anyone who participates either by phone or in-person can submit a recommendation, and so long as there is no objection by another participant, it will be included in the final list. The participants rank and prioritize the recommendations.

Of the approximately 168 unique recommendations arising from the SEC Government-Business Forum on Small Business Capital Formation (the "Forum") over the last 10 years that relate to the rules and regulations administered by the SEC, 49 have been acted on through rulemaking, interpretive guidance, no-action relief or other efforts by the Commission and its staff. Congress, through legislation, acted on an additional 18 recommendations. An additional 44 recommendations are currently under consideration by the Commission and its staff, the majority of which recommended changes to pending Commission rule proposals and will therefore be considered through the course of the normal rulemaking process.

Importantly, many of the recommendations that the Commission and the staff have acted upon were among the ones most widely-supported or frequently-requested by the small business community. These include:

- shortening the holding periods for resales under Rule 144 from one year to six months for the securities of reporting companies;
- simplifying Form D and developing a new online filing system for those forms;
- exempting compensatory employee stock options from registration under Section 12(g) of the Exchange Act of 1934;
- simplifying the disclosure and reporting requirements for smaller companies and allowing smaller companies to provide less burdensome, scaled disclosures;

- exempting smaller reporting companies from the say-on-pay and frequency votes required under the Dodd-Frank Act until 2013;
- proposing certain amendments to the exemption under Regulation A of the Securities Act of 1933 that were not mandated by the Jumpstart Our Business Startups Act but intended to facilitate the use of the exemption;
- clarifying the treatment of merger and acquisition brokers under Section 15(a) of the Securities Exchange Act of 1934;
- developing a pilot program to assess the impact of tick size on market liquidity for small-cap companies;
- providing guidance on certain aspects of “mark-to-market” accounting; and
- excluding small business investment companies (SBICs) from the definition of covered fund to limit the impact of the Volcker Rule on such funds and the small businesses in which SBICs may ultimately invest.

Of course, this is not an exhaustive list, but I believe it is indicative of the serious consideration we give to the recommendations made by participants in the Forum. In that regard, I look forward to continuing this productive, ongoing dialogue with the small business community in upcoming forums and other initiatives.

